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IN THE

Supreme Court of the United States

INTEGRATED TELECOM EXPRESS, INC. AND THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS,

Petitioners,

v.

NMSBPCSLDHB, L.P.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The Third Circuit's opinion suggests that this case "tests the limits" of good faith under the Bankruptcy Code. (App. A, *infra*, 2a.) To the contrary, the Third Circuit's ruling does not test the limits. It fundamentally changes the judicially created standard for good faith itself, in a move that brings the Third Circuit seriously out of alignment with other circuits.

Therefore, the questions presented are:

1. Whether it is in good faith for a solvent debtor to file a Chapter 11 petition for the primary purpose of limiting a landlord creditor's contract rights under 11 U.S.C. § 502(b)(6) where the resulting economic benefit devolves to equity holders after all creditors' allowed claims have been paid in full.

2. Whether good faith is an implicit requirement for any filing under Chapter 11 of the Bankruptcy Code, and, if so, whether the good faith filing requirement is satisfied when the debtor's Chapter 11 petition serves a distributive, rather than rehabilitative, purpose.

RULE 29.6 STATEMENT AND LIST OF PARTIES

Integrated Telecom Express, Inc. a/k/a Integrated Technology Express, Inc. a/k/a Delaware Integrated Telecom Express, Inc. has no parent corporation. United Microelectronics Corporation holds 10 percent or more of the company's stock.

The Official Committee of Equity Security Holders is not organized in a corporate form.

The Securities Claimants, all members of a class certified in *In re Integrated Telecom Express, Inc. Initial Public Offering Securities Litigation*, 01 Civ. 10108 (SAS) (S.D.N.Y.) as consolidated in *In re Initial Public Offering Securities Litigation*, Master File No. 121-MC-00092 (SAS) (S.D.N.Y.) and Class 3B under the Chapter 11 plan, are not a party but are being served through their counsel, Stamell & Schager, LLP, Attn: John Crow, Esq.

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Integrated Telecom Express, Inc. and the Official Committee of Equity Security Holders respectfully jointly petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit (App. A., *infra*, 1a-42a) is reported at 384 F.3d 108 (3d Cir. 2004). The memorandum order of the United States District Court for the District of Delaware (App. B, *infra*, 43a-60a) is unreported. The orders of the United States Bankruptcy Court for the District of Delaware (App. C, *infra*, 61a-75a; App. E, *infra*, 79a-80a) are unreported.

STATEMENT OF JURISDICTION

The United States Court of Appeals for the Third Circuit entered its judgment on September 20, 2004. (App. A, *infra*, 1a.) The Petitioners' timely petition for panel rehearing and rehearing *en banc* was denied on November 23, 2004. (App. D, *infra*, 76a-78a.) The Order of the United States Court of Appeals for the Third Circuit Denying Petition for Rehearing is reported at 389 F.3d 423 (3d Cir. 2004). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(*1*).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 109, (App. F, *infra*, 82a-84a), specifying who may be a debtor under the Bankruptcy Code.

11 U.S.C. § 502(b)(6), establishing the allowance of the claims of a lessor for damages resulting from a debtor's termination of a real property lease under the Bankruptcy Code as follows:

> "Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the

petition, and shall allow such claim in such amount, except to the extent that—

* * *

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates."

11 U.S.C. § 502(g), providing that a claim arising from the rejection, under section 365 of title 11 or under a plan under Chapter 9, 11, 12, or 13 of title 11, of an unexpired lease of the debtor that has not been assumed, "shall be determined and shall be allowed" pursuant to 11 U.S.C. § 502(b)(6).

11 U.S.C. § 1112(b), providing, in relevant part, for conversion or dismissal of a debtor's petition under Chapter 11 of the Bankruptcy Code for "cause."

11 U.S.C. § 1129(a)(3), providing, in relevant part, that a court shall not confirm a plan unless the plan "has been proposed in good faith and not by any means forbidden by law."

STATEMENT OF THE CASE

I. Factual Background

This is a case of a failed business. Reeling from a precipitous decline in revenues, bleeding capital, deemed no longer viable or saleable by its advisors, and having ceased all its productive operations, Integrated Telecom Express, Inc. (hereinafter referred to as the "Debtor" or "Integrated") was the epitome of economic

distress. Desiring to fulfill its fiduciary duty to its shareholders to liquidate the business and return the remaining capital to investors, the Integrated Board of Directors determined to utilize the Bankruptcy Code for the fundamental bankruptcy purpose of facilitating the company's liquidation, accordingly surrendering all of its property for purposes of "the equitable distribution of the debtor's assets" among the parties in interest. *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937).

Beginning in 1997, Integrated was a supplier to the broadband access communications equipment industry. Its products included integrated circuits and software that enabled communications equipment manufacturers to provide asymmetric digital subscriber line ("ASDL") equipment to communications service providers and their customers. The Debtor made an initial public offering of its stock on August 17, 2000, selling approximately 6 million shares at $18 per share, thus raising about $110 million.

In the summer of 2000, the Debtor and NMSBPCSLDHB, L.P., (the "Landlord")[1] began negotiating for a lease of real property in the Silicon Valley. The real estate market in the Silicon Valley was very active at that time, and many landlords in the area were able to command ten-year leases. The Debtor's lease, pertaining to 48,000 square feet of rentable space, was for a ten year term beginning on February 23, 2001, with a monthly base rent of approximately $200,000, increasing 5 percent annually.

Unfortunately for the Debtor, the market for ASDL equipment deteriorated rapidly, beginning in early 2001. The decline was attributed to a worldwide slowdown in the communications industry, and, in particular, a reduced demand for the Debtor's products in Asia. The Debtor's net loss for 2001 was $36.2 million. As a result, in December 2001, the Debtor hired Booz Allen Hamilton, a management and technology

[1] At the time of the negotiations, the Landlord's name was "Granum Holdings." Only the Landlord's name, and not its identity, has changed.

consulting firm, to help the Debtor evaluate its operating alternatives. In February 2002, the Debtor also hired Lehman Brothers, an investment bank, to assist in identifying, soliciting, and evaluating proposals for a sale or merger of the Debtor or its assets. Unable to find a third party willing to enter into such a transaction, the Debtor's Board began discussing a plan for the Debtor's liquidation and dissolution.

At an April 18, 2002 meeting, the Board approved a Plan of Complete Liquidation and Dissolution, under Delaware law. Thereafter, the Debtor and the Landlord attempted to reach a settlement regarding termination of the lease. At an August 13, 2002 meeting, the Board authorized a Chapter 11 filing if the Landlord would not enter into a settlement agreement with a maximum settlement amount of $8 million. On August 15, 2002, the Debtor's bankruptcy counsel sent the Landlord a letter notifying the Landlord that if the Landlord was unwilling to settle, the Debtor was prepared to seek protection under the Bankruptcy Code, including the cap on landlords' claims set forth in 11 U.S.C. § 502(b)(6). Ultimately, the Landlord and the Debtor were unable to reach an agreement.

Approximately two months later, after considering a number of factors, including the potential impact on the Landlord's claim and Integrated's potential liability exposure arising from a $93 million securities class action claim filed in the United States District Court for the Southern District of New York, Integrated's Board caused the Debtor to commence a liquidation under the protection of Chapter 11 of the Bankruptcy Code. Among other things, the Board determined that Chapter 11 would provide an efficient procedure for the liquidation of the Debtor's assets and would also liquidate and bring certainty to the contingent claims that threatened the Debtor's orderly, efficient, and necessarily rapid winding down of its business. A number of issues were taken into consideration, including the following.

First, Chapter 11 provided a framework for the Debtor to resolve the pending class action lawsuit in which the claimants asserted damages in the amount of $93 million. The Debtor is a

named defendant in the action captioned *In re Integrated Telecom Express, Inc. Initial Public Offering Securities Litigation*, No. 1:01-CV-10108, pending in the United States District Court for the Southern District of New York. The Securities Claimants bring claims for violation of several provisions of the Securities Act of 1933 and the Securities Act of 1934 against certain underwriters, Debtor, and various of its former officers and directors. Similar lawsuits concerning more than 300 other companies' initial public offerings have been filed and coordinated as *In re Initial Public Offering Securities Litigation*, No. 1:21-MC-00092, which is currently pending before the Honorable Shira A. Scheindlin in United States District Court for the Southern District of New York. The Chapter 11 filing enabled the Debtor to subordinate the claims of the securities claimants under 11 U.S.C. § 510(b), so that such claims were treated *in pari passu* with equity interests. This treatment enabled the prompt disposition of these claims, which otherwise would have stalled the Debtor's liquidation under state law indefinitely.

Second, Chapter 11 enabled the Debtor to quickly resolve the Landlord's claim for damages for future rent, providing the Landlord with Congress's estimate of a fair fixed damages recovery under 11 U.S.C. § 502(b)(6), without incurring the expense and delay of state law breach of contract proceedings.

Third, Chapter 11 facilitated the sale of Integrated's intellectual property portfolio. Not only was the sale free and clear of all claims, liens, and interests under the provisions of 11 U.S.C. § 363, but it ensured that a market value, rather than liquidation value, was obtained for the assets by virtue of court oversight over the sale process and the continued retention of critical employees.

Fourth, Chapter 11 enabled the Debtor to establish a bar date and define the universe of claims against it to assure that any distributions to its creditors and stockholders properly accounted for any inchoate claims, including various assertions regarding the Debtor's former management and former parent.

Fifth, Chapter 11 served as fair and efficient forum in which to quickly accomplish a winding down of the Debtor's operations. The efficiencies of Chapter 11 avoided the very great risk that the litigation related to the Landlord's breach of contract claim for future rent and the shareholder class action would stall any state law liquidation indefinitely. The Chapter 11 filing therefore enabled Integrated's Board to avoid the litigation expense, delay, and resultant exhaustion of the Debtor's remaining capital that would necessarily occur outside of bankruptcy.

On or about October 8, 2002, the Debtor had approximately $107 million in assets and $5 million in liquidated debts. However, the Debtor also faced approximately $114 million in contingent, unliquidated claims, including the Shareholder Class Action Lawsuit claiming damages of $93 million[2] and the remaining lease obligations to the Landlord. At the time, Integrated had no earnings whatsoever, and was otherwise required to meet ongoing corporate expenses, pending the completion of the winding down of its operations and final dissolution. Integrated's Board of Directors determined that a Chapter 11 filing was necessary to "minimize any loss of value to the Debtor's estate [by] liquidat[ing] its operations and wind[ing]-up its estate . . . with as little interruption as possible."

II. Proceedings Below

1. Proceedings Before the Bankruptcy Court. The Debtor filed its voluntary petition for relief under Chapter 11 of the

[2] Although the Debtor's proxy statement dated December 19, 2002 stated that "[t]he Company does not expect that the ultimate costs to resolve these claims will have a material adverse effect on the Company's financial position, results of operations, or cash flows," this was a forward-looking statement, subject to the following qualification:

> The forward-looking statements contained in this Proxy Statement . . . [are] subject to certain risks. . . . Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially.

Bankruptcy Code on October 8, 2002. On October 28, 2002, the Landlord moved to dismiss the Debtor's case under 11 U.S.C. § 1112(b), on the ground that the petition was filed in bad faith. The Bankruptcy Court held an evidentiary hearing on the Landlord's Motion to Dismiss on January 8, 2003. (App. C., *infra*, 61a-75a.) On January 30, 2003, the Bankruptcy Court entered an order denying the motion. (App. E, *infra*, 79a-80a.)

In analyzing the good faith issue, the Bankruptcy Court found the Debtor's solvency to be irrelevant. The Bankruptcy Court stated that, "as the case law clearly indicates, . . . the solvency of the debtor and the fact that the equity interest holders will receive a distribution does not serve as the basis for a finding of bad faith." (App. C, *infra*, 61a-62a.) The Bankruptcy Court also discussed the evidence presented at the hearing, and made specific findings of fact based on that evidence. (*See id.* at 62a-67a, 70a-71a.)

In particular, the Bankruptcy Court held the Debtor's "financial affairs" to be "distressful," noting that, in September 2001, the Debtor "was experiencing a dramatic downward spiral." (*Id.* at 70a-74a.) Furthermore, the Bankruptcy Court found the Debtor's proper liquidation purpose, stating that Integrated's Board was "absolutely right" in exercising "its fiduciary responsibility in pursuing a *liquidation course of action*" in order to fulfill its "obligation [] to give the investors their money back." (*Id.* at 71a (emphasis added).)

The Bankruptcy Court concluded that the Debtor "offered a number of reasons for the filing of the bankruptcy case" (*id.* at 63a) and then went on to say the following:

> But even assuming that those other factors are not particularly persuasive, even assuming or accepting the landlord's position, particularly illustrated by the Board of Directors' minutes of August 13 of 2002, that the principal reason for the Chapter 11 case was to cap the damage claim for the landlord, I conclude that as a matter of law, that is not a debilitating fact. I held in the *PPI*, and other cases have held, that it does not

> establish bad faith for a debtor to file a chapter case for the purpose of taking advantage of provisions which alter pre-petition rights, including altering the rights of a landlord under [s]tate law.

(*Id.* at 64a.)[3]

The Bankruptcy Court then went on to discuss the other decisions standing for the proposition that a "solvent debtor can avail itself of the § 502(b)(6) cap" (*Id.* at 67a) focusing in particular on *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002), finding the case to be "almost on all fours with the situation before me." (App. C, *infra*, 68a.) For all of these reasons, the Bankruptcy Court denied the Landlord's Motion to Dismiss.

The Debtor filed a Plan of Liquidation, followed by an Amended Plan of Liquidation dated February 5, 2003. The Landlord filed an objection to the confirmation of the Debtor's Plan, which was overruled by the Bankruptcy Court. On April 16, 2003, the Bankruptcy Court entered an order confirming the Debtor's Amended Plan of Liquidation ("Confirmation Order"). The Landlord timely appealed from the January 30, 2003 Order denying its motion to dismiss and the April 2003 Confirmation Order. On June 11, 2003, the parties stipulated to the consolidation of the Landlord's appeals. The Bankruptcy Court entered an order staying the Confirmation Order until April 30, 2004.

2. Proceedings Before the District Court. The District Court for the District of Delaware affirmed the Bankruptcy Court's orders, holding that the Bankruptcy Court did not abuse its

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[3] By "*PPI* and other cases," the Bankruptcy Court was referring to its earlier decision in *Solow v. P.P.I. Enters. (U.S.) Inc.*, (*In re PPI Enters. (U.S.), Inc.*), 228 B.R. 339 (Bankr. D. Del. 1998), *aff'd* 324 F.3d 197 (3d Cir. 2003). The other cases it discussed were *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002); *In re Federated Dep't Stores, Inc.*, 131 B.R. 808 (S.D. Ohio 1991); and *In re Farley, Inc.*, 146 B.R. 739 (N.D. III. 1992). (*See* App. C, *infra*, 67a-69a.)

discretion "in determining that the Debtor met the good faith requirement that is an implicit prerequisite to filing under Chapter 11." (App. B, *infra*, 54a.) The District Court found that the Bankruptcy Court's decision was "based on a sound interpretation of relevant case law from this and other jurisdictions," and did not constitute an abuse of discretion. (*Id.* at 56a.) The District Court took particular note of *In re Sylmar Plaza*, 314 F.3d at 1070, finding directly on-point its holding that "it is not bad faith to take advantage of a particular provision of the Bankruptcy Code for the purpose of capping the amount of a creditor's claim." (App. B, *infra*, 56a.) Furthermore, the District Court noted that the Ninth Circuit in *In re Sylmar Plaza* had "rejected the creditors' argument, much like the Landlord's argument here, that insolvency is a prerequisite to a finding of good faith under the Bankruptcy Code." (*Id.*)

The District Court held that the Debtor possessed a proper liquidation purpose for its filing: "[T]he Debtor was in financial distress and . . . the Board, consistent with its fiduciary responsibility, properly pursued liquidation in order to fulfill its obligations to its investors." (*Id.* at 55a.) The District Court found that the Bankruptcy Court advanced "many other valid reasons" for the filing of the bankruptcy case. (*Id.*)

The District Court alternatively approved the Bankruptcy Court's reasoning that "even if the Debtor's principal reason for filing its Chapter 11 case [had been] to cap the Landlord's damage claim, that alone was insufficient to establish bad faith." (*Id.*)

The District Court affirmed the Bankruptcy Court's decision, finding that the Bankruptcy Court had conducted "a fact-intensive inquiry and balancing [of the] totality of the circumstances of [the] case, [and] exercised sound discretion when it reached its decision that the Debtor's Chapter 11 filing satisfied the good faith requirement." (*Id.* at 60a.)

3. Proceedings Before the Third Circuit. The Landlord filed a timely appeal from the decision of the District Court. The

Third Circuit expedited the appeal and stayed the Confirmation Order pending the appeal. The Third Circuit found that the Debtor's Chapter 11 petition was filed in bad faith and was subject to dismissal under 11 U.S.C. § 1112(b). It therefore reversed the order of the District Court affirming the Bankruptcy court's denial of the Landlord's motion to dismiss and remanded the case to the Bankruptcy Court with instructions to dismiss Integrated's Chapter 11 petition. (App. A, *infra*, 3a, 17a, 42a.)

The Third Circuit's essential holding was that a petition is not filed in good faith where it is: (i) filed by a "financially healthy" debtor, (ii) who is filing a plan of liquidation with no intention of reorganizing or liquidating as a going concern, (iii) "solely to take advantage of a provision in the Bankruptcy Code that limits claims on long-term leases" and (iv) where value maximized by the liquidation devolves to equity holders after creditors' allowed claims are paid in full. (*Cf. id.* at 3a.)

The Third Circuit framed the issue in terms of whether the petition served a valid bankruptcy purpose, *e.g.*, by preserving going concern value or otherwise maximizing the value of the debtor's estate. (*Id.* at 20a.) The court disposed of the fact that Integrated had any "going concern value to preserve" because it was "out of business." (*Id.* at 22a.) Therefore, it focused on whether Integrated's filing had maximized the value of the estate and, citing to a law review article, ruled that Integrated's petition could not be in good faith unless it maximized the value of the estate by "alleviating the problem of financial distress." (*Id.* at 22a-23a.)

The Third Circuit proceeded to define "financial distress" in balance sheet terms of debt in excess of equity. Although the Third Circuit acknowledged that Integrated "was losing a lot of money" and "was experiencing a dramatic downward spiral" (*id.* at 26a), the court declined to consider this form of distress to presuppose a need to file for liquidation. The court focused on Integrated's balance sheet solvency: "We do not see how bankruptcy offers Integrated any relief from this sort of distress,

which has no relation to any *debt* owed by Integrated." (*Id.* (emphasis added).)

The court otherwise disregarded Integrated's contentions that the filing was necessary to enable it to maximize value of the estate by subordinating a $93 million contingent securities class action claim under the efficiencies of 11 U.S.C. § 510(b). (*Id.* at 30a-34a.) While acknowledging that this contingent, unliquidated claim otherwise threatened to stall the Debtor's liquidation indefinitely, the court discounted the importance of this fact. (*Id.*) The court otherwise discounted the import of the $93 million contingent claim, describing it as *de minimis*, citing to statements concerning resolution of the claim that were contained as part of the "soft" forward-looking information in the Debtor's prospectus. (*Id.*) Likewise, although the court acknowledged that $1 million in value had been maximized in bankruptcy through the sale of the Debtor's intellectual property assets, it otherwise stated that "this fact hardly justifies an invocation of Chapter 11." (*Id.* at 35a.)

The Third Circuit rejected the argument that the Debtor possessed a proper purpose for filing where Chapter 11 provided a proper forum for a "quick, efficient, and orderly winding down of the operations" of the Debtor's failed business, stating that "distribution, standing alone [was not] a valid bankruptcy purpose." (*Id.* at 34a.) Nor did the court find it significant that the Chapter 11 filing enabled the Debtor to establish a bar date and define the universe of claims against it to assure that any distributions to its creditors and stockholders accounted for, and satisfied, any inchoate claims. (*Id.* at 37a.).

As such, the Third Circuit imposed the drastic remedy of dismissal.

The Petitioners filed timely petitions for panel rehearing and rehearing *en banc*. The Third Circuit denied Petitioners' petitions for panel rehearing and rehearing *en banc* on November 23, 2004. (App. E, *infra*, 79a-80a.)

REASONS FOR GRANTING THE PETITION

The ruling by the Third Circuit in this case redefines the meaning of bankruptcy. In a bold act of judicial activism—and absent statutory authority—the Third Circuit has imposed a rule that denies access to the Bankruptcy Code by an economically distressed debtor seeking to liquidate under the protection of the Bankruptcy Code.

Informed neither by Supreme Court precedent nor by persuasive holdings of other federal circuit courts of appeal, the Third Circuit's ruling has created a circuit split that will cause great mischief. The uncertainty created by this ruling will discourage debtors from filing petitions in Chapter 11, whether such debtors intend to propose a liquidating plan or merely wish to preserve the right to liquidate under Chapter 11 plans of reorganization. Indeed, the broad policy changes to the bankruptcy system implicated by this opinion have the potential for a far-reaching, profound effect far removed from the discrete facts of this case:

> Because the functions of the bankruptcy system are deeply intertwined, a single change has the potential to create multiple effects throughout the system. Moreover, changes pursued for one end may simultaneously move the system further away from a number of other objectives.

Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 387 (1993).

The Petitioners therefore respectfully submit that the Third Circuit erred gravely in its fundamental restatement of the policies and values of the Bankruptcy Code and that the impact of these errors is important and creates a serious conflict among the circuits courts of appeal. Thus, this appeal warrants this Court's review. To emphasize:

Review is merited, *first*, because the decision is in direct conflict with that of the Ninth Circuit in *Platinum Capital, Inc.*

v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.), 314 F.3d 1070 (9th Cir. 2002).

Second, review is merited to determine whether in light of principles of statutory construction and in light of the legislative history of the Bankruptcy Code, the judicially created good faith filing requirement is even permissible, and, if so, to clarify the standard. The decision of the Third Circuit compounds the general confusion and disarray among the circuit courts of appeal as to the scope, construction, and policy goals of the implied good faith requirement for Chapter 11 filings.

Third, review is justified where the decision of the Third Circuit has set aside the plain language of the Bankruptcy Code, in favor of its own substantive determination of whether the distribution scheme under Chapter 11 is equitable or creates "hardship" on a creditor in the case of a solvent debtor. (*See* App. A, *infra*, 22a n.4.) Such unlimited judicial discretion that interferes with the ability of solvent debtors to file under Chapter 11 under the rubric of "good faith" is error in light of the plain language of the Bankruptcy Code.

Fourth, the decision of the Third Circuit requires review because it impermissibly narrows the availability of liquidating plans of reorganization under Chapter 11, thereby abrogating the important, fundamental right of a debtor in economic distress to liquidate and effectuate an orderly and economically efficient distribution of its assets under the Bankruptcy Code. Congress otherwise requires that "there should be *no legal barrier* to voluntary petitions." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137-93, pt. 1, at 75 (1973) (emphasis added).

Indeed, other than the decision of the Third Circuit below, no other federal court of appeals has denied a liquidating debtor the right to surrender its assets to the court for equitable distribution under the Bankruptcy Code, absent egregious conduct akin to fraud.

A. The Third Circuit's Construction of the Judicially Created Good Faith Filing Requirement Conflicts with the Holdings of Other Circuits

1. The Decision Is in Direct and Irreconcilable Conflict with the Decision of the Ninth Circuit in *In re Sylmar Plaza*

As both the Bankruptcy Court and the District Court recognized, *In re Sylmar Plaza, L.P.*, 314 F.3d at 1070, is "almost on all fours" with this case. (*See* App. B, *infra*, 55a-56a; App. C, *infra* 67a-74a.) *In re Sylmar Plaza* holds that it is not bad faith for a solvent debtor to file a petition under Chapter 11 in a case where the debtor's sole purpose for filing is to avoid a contractual liability through the operation of a provision of the Bankruptcy Code and where the debtor "profit[s] personally at the expense of a creditor." *In re Sylmar Plaza, L.P.*, 314 F.3d at 1074-75.

The facts of *In re Sylmar Plaza* reveal that it is analytically indistinguishable with this case, when viewed in the context of the proper purposes for a Chapter 11 filing. *In re Sylmar Plaza* was a classic "strategic filing."[4] The debtor in *In re Sylmar Plaza* owned a diverse real estate portfolio worth more than $55 million, with a net equity exceeding $15 million. *Id.* at 1072. The Sylmar Plaza property was subject to a secured loan of $8,073,237 carrying a fixed interest rate of 8.87 percent, but a default rate at 13.87 percent. *Id.*

When the Sylmar Plaza property encountered cash flow problems, the owners transferred the property to a new limited partnership and sheltered their other assets in four other newly-created limited partnerships. Sylmar Plaza, L.P. filed its Chapter 11 case the day after the state court foreclosure proceeding issued a preliminary decision in favor of Platinum,

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[4] A strategic filing is a filing where the debtor makes a filing to take advantage of a particular aspect of bankruptcy law. *See* Janet A. Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Bankruptcy Petitions*, 67 AM. BANKR. L.J. 401, 432-33 (1993).

thereby creating what is commonly known as a "new-debtor" case.[5] *Id.* at 1072-73.

Similar to the debtor in this case, the debtor in *Sylmar Plaza* liquidated its assets under Chapter 11. *Id* at 1073. Both objectively and subjectively, the debtor's sole purpose for filing was to benefit the owners of the partnership by virtue of the operation of a provision of the Bankruptcy Code that limited a creditor's contract rights. *Id.* Like the Debtor's plan in this case, all creditors' allowed claims were to be paid in full. *Id.* Thus, the benefit of the recovery vis-à-vis the limitation on the creditor went to holders of equity interests, and not to any creditor.[6]

Because the debtor's plan effected a "cure" of the default on the loan, all interest due to the sole creditor, Platinum, was calculated at the lower 8.87 percent non-default rate.[7] The creditor therefore complained that the plan was not proposed in good faith.[8] The Ninth Circuit rejected this argument, holding

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[5] "[T]hese are new entities created or old entities revived in order to take an asset into chapter 11. Almost all new debtor cases have but a single asset." Such debtors have historically been deemed to be potential candidates for dismissal on good faith grounds. *See id.* at 406-07. *See generally* AM. BANKR. INST., SINGLE ASSET REAL ESTATE BANKRUPTCIES (1997).

[6] The plan called for Sylmar Plaza to be sold free and clear of all liens and for both Platinum's allowed secured and unsecured claims to be paid in full. 314 F.3d at 1073.

[7] The difference in interest amounted to approximately $1 million. *Id.*

[8] Although *In re Sylmar Plaza* involves the construction of good faith in the debtor's proposal of a plan under 11 U.S.C. § 1129(a)(3), rather than the judicially-implied good faith standard for the filing of a chapter 11 petition, this difference is immaterial. First, this case was a consolidated appeal, where the issue of good faith under § 1129(a)(3) was disposed of as part of the court's good faith filing determination. (*See* App. A, *infra*, 35a n.4; App. B., *infra*, 68a.) Second, the Third Circuit generally conflates the analysis of the two standards into one. *See, In re PPI Enters. (U.S.)*, 324 F.3d at 210-11. Third, under principles

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that the debtor's plan "was proposed in good faith under 11 U.S.C. § 1129(a)(3) where its sole purpose was to enable the debtors to . . . avoid[ ] a contractual liability for default interest." *Id.* at 1072.

The Third Circuit's attempts to distinguish *In re Sylmar Plaza* are inapt. First, the Third Circuit suggests that *In re Sylmar Plaza* is distinguishable because in that case, "the Bankruptcy Code was used to maximize value for creditors as a whole." (*See* App. A, *infra*, 29a.) However, this statement is irreconcilable with the facts of *In re Sylmar Plaza*—in *In re Sylmar*, the debtors "profited *personally* at the expense of a creditor," 314 F.3d at 1074 (emphasis added), and the Ninth Circuit found this was in good faith. Furthermore, in *In re Sylmar*, the debtors "ha[d] no creditor problems other than Platinum," whose claim was limited. *See* Appellee's Brief at 11, *In re Sylmar Plaza, L.P.*, 314 F.3d 1070 (9th Cir. 2002) (No. 00-57210). Logically then, in *In re Sylmar*, where the sole creditor received no value from the only purpose of the filing (obtaining a non-default interest rate), the value was maximized for equity holders alone and not for "creditors as a whole."

Furthermore, the Third Circuit's alternative rationale for distinguishing *In re Sylmar Plaza*—that "there is no indication that [the debtors] would have come out solvent had the bank's claim not been limited, or that solvency was a foregone conclusion when the petition was filed" (*see* App. A, *infra*, 29a.)—ignores the fact that the court's good faith review in *In re Sylmar* took place at the time of confirmation of the plan, when the debtor's solvency had already been determined. Furthermore, a debtor's solvency is otherwise irrelevant to the determination of a debtor's good faith, at any point in the proceedings.

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of statutory construction, normally, identical words in "different parts of the same act are intended to have the same meaning," *Sullivan v. Stroop*, 496 U.S. 478, 484 (1990).

The Third Circuit's additional attempt to distinguish the rule *In re Sylmar Plaza* (without citation to the decision) fully reveals the striking, direct conflict between rule in this decision and the rule in *In re Sylmar Plaza*. (*Compare* App. A, *infra*, 38a. ("The . . . question is whether a desire to take advantage of a particular provision in the Bankruptcy Code, standing alone, establishes *good* faith. We hold that it does not."),[9] *with In re Sylmar Plaza*, 314 F.3d 1072 (holding that the debtor's plan "was proposed in good faith under 11 U.S.C. § 1129(a)(3) where its sole purpose was to enable the debtors to . . . avoid[] a contractual liability for default interest")).

As such, the decision of the Third Circuit is in direct conflict with a decision of the Ninth Circuit with respect to the important issue of whether a solvent debtor who files for the primary purpose of taking advantage of a provision of the Bankruptcy Code should have its petition dismissed for bad faith.

2. Confusion and Disarray Otherwise Pervade the Adjudication of the Judicially Created Good Faith Filing Standard for Chapter 11 Petitions

The Court's grant of certiorari in this case will also afford it an opportunity to bring clarity to the prevailing confusion and disarray that exist with respect to the implied good faith filing standard for a Chapter 11 petition.

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[9] The Third Circuit went on to reason that "[j]ust as a desire to take advantage of the protections of the Code cannot establish *bad* faith as a matter law, that desire cannot establish *good* faith as a matter of law." (App. A., *infra*, 38a.) This syllogism is circular. If the Debtor's conduct is not good faith nor bad faith, then what is it?

The Ninth Circuit's approach (*i.e.*, lack of bad faith equates to good faith) is the more reasoned view. Good faith as generally applied by the courts "is best understood as an 'excluder' . . . a phrase which has no general meaning or meanings of it own, but which serves to exclude many heterogeneous forms of bad faith." Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 196 (1968).

First, this Court has never expressly determined whether such judicially created standard is permissible. The legislative history brings into serious question the appropriateness of any non-statutory good faith filing standard. Congress deliberately eliminated the statutory "good faith filing requirement" that had operated to bar the use of liquidating plans under Chapter X.[10] "Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded." *INS v. Cardoza-Fonseca*, 480 U.S. 421, 442-43 (1987).

Second, serious disruption has resulted from the failure of the circuit courts of appeal to agree on what the standard should be. Under the current state of affairs, a debtor's access to Chapter 11 of the Bankruptcy Code often hinges more on the jurisdiction of the case than on the facts of the case. For example, some courts construe bad faith *in pari materia* with 11 U.S.C. § 1112(b)(1),[11] looking only to facts demonstrating that the debtor has no feasible hope of rehabilitation.[12] Others require findings of both the objective futility of any rehabilitation as well as a showing of the debtor's subjective bad faith.[13] Others (such as the Third Circuit), utilize a greater degree of discretion, determining the debtor's bad faith objectively, considering

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[10] The "good faith" standard was contained in Section 146 of the old Act, which provided that a petition under Chapter X was not filed in good faith where there was no prospect that the debtor could be reorganized, *i.e.*, where a liquidation was known to the be inevitable result. *See, e.g., Fid. Assurance Ass'n v. Sims*, 318 U.S. 608 (1943), *overruled by statute.*

[11] This section provides that a case may be dismissed for cause where there is "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation."

[12] *See C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304 (2d Cir. 1997); *Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068 (5th Cir. 1986); *Westbrook v. Albany Partners, Ltd. (In re Albany Partners, Ltd.)*, 749 F.2d 670, 674 (11th Cir. 1984).

[13] *See Carolin Corp. v. Miller*, 886 F.2d 693, 694 (4th Cir. 1989).

whether, under the totality of the circumstances, the debtor has a "valid reorganizational purpose."[14] Others give a very limited role to the implied good faith filing standard, holding that sufficient efforts to reorganize otherwise negates any finding of a bad faith filing.[15]

Third, the circuit courts are in hopeless analytical disarray as to the application of the standard to a debtor liquidating under Chapter 11. The varied tests among the circuits establish not only a split of authority, but also a need for this Court to instruct on the powers of equity which should guide the circuits in bankruptcy filings. In particular, the bankruptcy goals which have traditionally been recognized as the basis of equitable powers in Chapter 11 reorganizations are simply not applicable to a corporation liquidating under Chapter 11. The goal of a Chapter 11 liquidation is liquidating the assets and efficiently reducing to a sum certain the liabilities of the debtor corporation, along with equitable distribution of assets to parties in interests—a "true reorganization" goal is simply inapplicable.

Review and clarification of the good faith filing standard by the Court will therefore have important economic and social consequences: It will bring needed uniformity among the circuits with respect to who may be a debtor under Chapter 11, it will remedy the forum shopping and inequitable results that have resulted as a result of the systemic confusion over the applicable standards and policy goals that should apply to Chapter 11 liquidations, and it will rectify the havoc and economic disruption that is now brought about under a vague and ambiguous standard for good faith, where a liquidating Chapter

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[14] *See In re SGL Carbon Corp.*, 200 F.3d 154, 156 (3d Cir. 1999); *see also Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.)*, 324 F.3d 197 (3d Cir. 2003); *see also Laguna Assocs. L.P. v. Aetna Cas. & Sur. Co. (In re Laguna Assocs. L.P.)*, 30 F.3d 734, 738 (6th Cir. 1994); *but cf. In re Winshall Settlor's Trust*, 758 F.2d 1136, 1137 (6th Cir. 1985) (stating the factors in terms of the objective futility of a reorganizational effort).

[15] *In re Madison Hotel Assocs.*, 749 F.2d 410, 426 (7th Cir. 1984).

11 case is dismissed after parties in interest have materially changed their positions in reliance on the Chapter 11 proceeding.

B. Review is Merited Because the Third Circuit's Construction of the Judicially Created Good Faith Filing Requirement for a Chapter 11 Petition Abrogates the Express Language of the Bankruptcy Code

The decision of the Third Circuit merits review by this Court because it construes good faith so as to place additional substantive burdens on who may be a debtor under Chapter 11. *See* 11 U.S.C. § 109 (containing no exclusion for solvent persons when defining who may file a Chapter 11 petition). This decision is error where this Court rejected a comparable judicially-implied limitation on who may be a debtor in *Toibb v. Radloff*, 501 U.S. 157, 161 (1991): "[W]e are loath to infer the exclusion of certain classes of debtors from the protections of Chapter 11, because Congress took care in § 109 to specify who qualifies—and who does not qualify—as a debtor under the various chapters of the Code." *Toibb* therefore holds that only § 109 controls who can file in Chapter 11. *Id.*

Notwithstanding, the Third Circuit's construction of good faith seeks to place many implied limitations on who may file a petition, holding that the doctrine of good faith excludes any debtor from the protections of the Bankruptcy Code who: (i) is solvent, (ii) files a plan of liquidation with no intention of reorganizing or liquidating as a going concern, and/or (iii) files "solely to take advantage of a provision in the Bankruptcy Code that limits claims on long-term leases" where the benefit devolves to equity holders after creditors' allowed claims are paid in full. (*Cf.* App. A, *infra*, 3a.) Each of these actions is permitted under the Bankruptcy Code, either expressly or by implication. Therefore, taken together they cannot constitute bad faith.

First, bad faith is not implicated simply because a debtor is solvent. Congress knows how to craft express insolvency requirements into the Bankruptcy Code, and none are applicable

to Chapter 11.[16] Furthermore, where the language of a statute includes express limitations, this Court has consistently rejected the implication of other judicial limitations into the language of the statute. *See, e.g.*, *Nat'l Labor Relations Bd. v. Bildisco & Bildisco*, 465 U.S. 513, 522-23 (1984) (refusing to exclude collective bargaining agreements from the definition of executory contracts subject to rejection under 11 U.S.C. § 365(a) where the Bankruptcy Code otherwise contained express exemptions for other types of contracts); *cf. Johnson v. Home State Bank*, 501 U.S. 78, 87 (1991) (holding that implied judicial limitations are improper where a statute otherwise provides express limitations).

Unable to bring in an insolvency requirement directly, the Third Circuit effectively brought it in indirectly by imposing a good faith filing standard that distinguished and discriminated between two separate classes of liquidating debtors: solvent and insolvent. This result was accomplished by coupling good faith with the requirement that, to maximize value, a debtor must be insolvent in the strict balance sheet sense. (*See* App. A, *infra*, 23a (limiting good faith under Chapter 11 to a situation where value is maximized where there "are not enough assets to go around" to satisfy creditors).)

Furthermore, the Third Circuit framed its value maximization discussion in terms of whether the debtor was "financially healthy," (*see* App. A, *infra*, 3a), or in "financial distress" (*see id.* at 23a-27a)—not solvent. This linguistic alteration, however, fails to provide any meaningful substantive distinction—the concept remains one of solvency, as demonstrated by reference to the facts of this case.

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[16] *Compare* 11 U.S.C. § 109(c) (requiring insolvency for a Chapter 9 filing) *with* § 109(b) (no insolvency required for a Chapter 7 filing) *and* § 109(d) (no insolvency required for a Chapter 11 filing). Chapter 11's ample provisions for protection of the interests of equity security holders also speaks to the fact that Congress contemplated, as well as approved, filings by solvent debtors. *See* 11 U.S.C. § 1102.

The record in this case is incontroverted that the Debtor was unprofitable, was not viable as a going concern, and "was experiencing a dramatic downward spiral." Indeed, Integrated was in *economic distress*—that is to say, it had negative operating cash flow and no economic viability—the classic descriptor for a proper candidate for liquidation.[17] Although it appeared that Integrated was solvent, it immediately needed to staunch the bleeding of capital and to preserve the value of its remaining assets from further erosion. That goal was endangered by contingent liabilities that threatened to stall its wind down of operations "indefinitely." (*See* App. A, *infra*, 33a.) Only by resort to the Bankruptcy Code could the Debtor efficiently fix its contingent liabilities to a sum certain.

Because there is no finding in the record that the Debtor was either profitable or viable, the Third Circuit's "financially healthy" neology is necessarily a reference to the Debtor's balance sheet solvency (although the court avoided use of that terminology). As such, the Third Circuit's holding impermissibly tethered the debtor's eligibility to file a Chapter 11 petition to considerations of a debtor's solvency, in direct contradiction to the dictates of § 109 of the Bankruptcy Code.

Second, the Third Circuit erred in its statement that a debtor must liquidate "as a whole" or in such as way as to "preserve some going concern value." (*See* App. A, *infra*, 21a n.4.) To the contrary, the Bankruptcy Code allows plans where "the debtor does not engage in business after consummation of the plan." 11 U.S.C. § 1141(d)(3)(B). Furthermore, Chapter 11 expressly provides for the sale of "all or any part" of the property of the estate under a plan, and thus does not require liquidation of an entity as a whole. *See* 11 U.S.C. § 1123(a)(5)(D). Therefore,

[17] "Economic distress" is a term describing an entity with operating revenues less than its operating costs, which is not viable and should be liquidated. "Financial distress" is a term describing an entity that cannot pay its bills, which is viable and should be reorganized. Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. L. REV. 85, 87 (1995). Chapter 11 provides protection in both types of cases.

the Third Circuit's engrafting of any "going concern" requirement for liquidations under Chapter 11 is irreconcilable with the plain language of the Bankruptcy Code.

Third, the Third Circuit arbitrarily limited the Debtor's access to Chapter 11 under the rubric of "good faith" where it deemed the limitation of a landlord creditor's state contract rights under the claim allowance scheme mandated by Congress under 11 U.S.C. § 502(b)(6) to be an unfair "hardship" on the creditor under its assessment of the facts and circumstances of the case. (*See* App. A, *infra*, 22a n.4.) Courts, however, may "not sit to assess the relative merits of different approaches to various bankruptcy problems. . . . Achieving a better policy outcome . . . is a task for Congress, not the courts." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 13 (2000).

Although the Third Circuit appeared disturbed by the notion that equity holders should profit at the expense of a landlord creditor, it is well settled that it is entirely permissible for equity holders to profit from the Bankruptcy Code's limitation on a creditor's claim. *See Kuehner v. Irving Trust Co.*, 299 U.S. 445 (1937) (interpreting a substantially similar provision under the Bankruptcy Act, holding that the surplus over the capped amount of a landlord's claim could accrue "to the benefit of stockholders" because such surplus does not have priority over the interests of stockholders); *accord In re Sylmar Plaza*, 314 F.3d at 1074 (stating that debtors may profit personally "at the expense of" a creditor under the operation of the Bankruptcy Code). Nor does the result offend the dictates of the absolute priority rule, because here the Landlord's claim was legally unimpaired where its allowed claim was to be paid in full. *See* 11 U.S.C. § 1129(b)(2).[18]

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[18] The absolute priority rule merely provides that a debtor's plan treat all classes of creditors fairly and equitably. 11 U.S.C. § 1129(b)(2)(B)(iv); *see also Bank of Am. Nat'l Trust & Savs. Assoc. v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 444, 448-49 (1999) (remarking that under 11 U.S.C. § 1129(b)(2), Congress modified the pre-Code (Cont'd)

In sum, the Third Circuit's definition of "good faith" opts in favor of a "Chancellor's Foot"[19] determination of the equities under the particular facts and circumstances of the case, rather than obeying the plain language[20] of the Bankruptcy Code that the claim "shall be determined" and "shall be allowed" pursuant to 11 U.S.C. § 502(b)(6). *See* 11 U.S.C. § 502(g). Using a common law good faith filing requirement to negate the effect of Congress's express limitation on a landlord's claim does violence to the plain language of the Bankruptcy Code.[21] As such, the Third Circuit has legislated rather than interpreted. Its opinion is therefore an unconstitutional judicial foray into Congress's plenary jurisdiction over the subject of bankruptcies.

C. The Third Circuit Erred By Excluding Distribution As a Proper Bankruptcy Purpose

The opinion of the Third Circuit contains a foundational analytical error. The court failed to recognize the essential difference in the good faith inquiry between a liquidation, which serves distributional purposes, and a reorganization, which serves rehabilitative purposes. Chapter 11 serves both goals.

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absolute priority rule, which had provided that "the creditors . . . be paid before the stockholders could retain [equity interests] for any purpose whatsoever") (alteration in original)).

[19] "Tis all one as if they should make the standard for the measure the Chancellor's foot. What an uncertain measure would this be! One Chancellor has a long foot, another a short foot, a third an indifferent foot; 'tis the same thing in the Chancellor's conscience." JOHN SELDEN, *Equity*, *in* TABLE TALK (1689).

[20] *Cf. Tymshare, Inc. v. Covell*, 727 F.2d 1145, 1153-54 (D.C. Cir. 1984) (Scalia, J.) ("It is possible to draw a contract as to leave decisions absolutely to the uncontrolled discretion of one of the parties and in such a case the issue of good faith is irrelevant.").

[21] Collier notes that the Congressional limitation on a landlord's claim is "absolute" because it is based on principles of fairness, *i.e.*, a landlord is not similarly-situated to other creditors because the landlord receives its property back and seeks recovery on a contingent, speculative claim. 4-502 COLLIER ON BANKRUPTCY ¶4-502.03 (15th ed. rev. 2004).

See 11 U.S.C. § 1123(a)(5)(D) (declaring that "notwithstanding any other applicable nonbankruptcy law," a plan may provide for "the distribution of all or any part of the property of the estate among those having an interest in such property of the estate"). Indeed, value in a liquidation is maximized by the efficiencies which Chapter 11 brings to the distributive process.[22]

Nevertheless, the Third Circuit's construction and application of the good faith filing requirement imposed a very limited liquidation (that is, distributive) purpose for Chapter 11. (*See* App. A, *infra*, 34a.) ("Nor is "distribution," standing alone, a valid bankruptcy purpose. . . . Antecedent to any such distribution is an inquiry whether the petition and plan are filed in good faith."). This interpretation, although perhaps facially appealing, ignores the legislative history. As stated above, Congress deliberately eliminated the statutory "good faith filing requirement" that had operated to bar the use of liquidating plans under Chapter X.[23] When Congress deemed it desirable to include liquidating plans under Chapter 11, it accordingly abandoned the express good faith filing requirement for Chapter 11 petitions.[24] As such, the legislative history brings into serious question the appropriateness of using any non-statutory good faith filing standard. *See INS v. Cardoza-Fonseca*, 480 U.S. at

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[22] Put simply, the "greater value" to be derived from a Chapter 11 liquidation is achieved—not necessarily by capturing the going-concern value of a going business—but also by the Bankruptcy Code's efficiencies and collective action processes, which operate to maximize the value of both the numerator (*i.e.*, increasing the value of assets) as well as of the denominator (efficient liquidation of claims) in the value equation.

[23] The "good faith" standard was contained in Section 146 of the old Act, which provided that a petition under Chapter X was not filed in good faith where there was no prospect that the debtor could be reorganized, *i.e.*, where a liquidation was known to the be inevitable result.

[24] *See* Janet A. Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Bankruptcy Petitions*, 67 AM. BANKR. L.J. 401, 412-15 & nn. 76-77 (1993) (discussing the legislative history).

442-43 ("Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded.").

Liquidating plans are expressly contemplated under Chapter 11,[25] and their importance to the general health and efficiencies of the U.S. economy cannot be gainsaid. Indeed, liquidating plans serve an important economic need, largely filling the role traditionally occupied by Chapter 7 in the liquidation of large corporations:

> With the large and apparently increasing number of liquidating plans in chapter 11, it may now be rare for a business of any size to liquidate in chapter 7. . . . There are two corporate chapters: chapter 7 for liquidating small businesses no one wants to fool with any more, and chapter 11 for all the rest.

Elizabeth Warren, *Remembering Chapter 7*, 23-4 AM. BANKR. INST. J. 22, 22 (2004).

As demonstrated by Congress's deletion of any express good faith filing requirement from Chapter 11 when it incorporated the use of liquidating plans into that Chapter, liquidations simply have not been subject to the same good faith review as reorganizations. Indeed, there is no good faith filing requirement under Chapter 7. "[T]he power to dismiss a chapter 7 case for lack of good faith, if it exists at all, is extremely limited." 6-707 COLLIER ON BANKRUPTCY ¶707.03[2] (15th ed. rev. 2004) (footnote omitted). This is because where a liquidation "requires no ongoing relationship between the debtor and its creditors [it] should be available to any debtor willing to surrender all of its nonexempt assets, 'regardless of whether the debtor's motive in seeking such a remedy was grounded in good faith.'" *Neary v. Padilla (In re Padilla)*, 222 F.3d 1184, 1193 (9th Cir. 2000)

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[25] *See* 11 U.S.C. § 1123(a)(5)(B), (D); § 1123 (b)(4) (providing for the sale of all or substantially all of the property of the estate and the distribution of the proceeds of such sale among holders of claims or interests); § 1129(a)(11) (providing for confirmation of a liquidating plan).

(quoting Kimlinger & Wassweiler, *The Good Faith Fable of 11 U.S.C. § 707(a): How Bankruptcy Courts Have Invented a Good Faith Filing Requirement for Chapter 7 Debtors*, 13 BANKR. DEV. J. 61, 65 (1996)).[26]

Similarly, here the Bankruptcy Court found that the Debtor had pursued a valid liquidation purpose for filing its Chapter 11 petition, *i.e.*, that Integrated's Board was "absolutely right" in exercising "its fiduciary responsibility in pursuing a liquidation course of action." In order to fulfill its "obligation [] to give the investors their money back." (App. C., *infra*, 71a.) As such, the Debtor's purpose of equitable distribution of its assets to parties in interest, *standing completely alone*, fulfilled the quintessential, fundamental purpose of bankruptcy:

> [The congressional jurisdiction over the subject of bankruptcies] extends to all cases where the law causes to be *distributed*, the property of the debtor among his creditors: *this is its least limit*. Its greatest, is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject — *distribution and discharge* — are in the competency and discretion of Congress. With the policy of a law . . . permitting the bankrupt to come in voluntarily, and be discharged without the consent of his creditors, *the courts have no concern; it belongs to the lawmakers*.

Nelson v. Carland, 42 U.S. 265, 281 (1843) (emphasis added).

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[26] Although rare cases have found bad faith in a Chapter 7 liquidation, these cases all concern extreme circumstances, such as fraud, the hiding of assets, or other egregious conduct. *See, e.g., Tamecki v. Frank (In re Tamecki)*, 229 F.3d 205 (3d Cir. 2000); *Huckfeldt v. Huckfeldt (In re Huckfeldt)*, 39 F.3d 829 (8th Cir. 1994) (refusing to find bad faith except in cases of extreme misconduct falling outside the purview of more specific Code provisions). This case could not present a starker contrast. Here, Integrated's Board of Directors sought to fulfill its fiduciary responsibility to shareholders by seeking liquidation under bankruptcy protection after consulting with counsel and its financial advisors.

The decision of the Third Circuit has carried the doctrine of good faith into the impermissible territory of judicial activism, creating a serious circuit split with the Ninth Circuit in the process. Congress has affirmatively deleted the express good faith filing requirement that previously served to bar liquidating plans of reorganization, determining that that "there should be *no legal barrier* to voluntary petitions." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137-93, pt. 1, at 75 (1973) (emphasis added). Therefore, any limitation on the right of a debtor to liquidate and surrender its assets to the control of the court for equitable distribution to parties in interest under Chapter 11 must come from Congress, not the courts.

CONCLUSION

For all of the above reasons, the Petitioners respectfully submit that this Court's Writ of Certiorari should issue to review the decision of the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED SEPTEMBER 20, 2004

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Case No.: 04-2411

IN RE: INTEGRATED TELECOM EXPRESS, INC. a/k/a INTEGRATED TECHNOLOGY EXPRESS, INC. a/k/a DELAWARE INTEGRATED TELECOM EXPRESS, INC.,

Debtor

NMSBPCSLDHB, L.P.,

Appellant

v.

INTEGRATED TELECOM EXPRESS, INC.; and THE OFFICIAL COMMITTEE OF EQUITY HOLDERS, et al.

On Appeal From The United States District Court
For The District Of Delaware
(Civ. A. No. 03-236-KAJ)

District Judge: The Honorable Kent A. Jordan

Argued Aug. 3, 2004

(Filed: September 20, 2004)

Before SMITH, BECKER, and GREENBERG,
Circuit Judges.

Appendix A

OPINION

SMITH, *Circuit Judge.*

This appeal tests the limits of the good faith requirement applicable to petitions filed under Chapter 11 of the Bankruptcy Code. Appellant NMSBPCSLDHB, L.P. (the "Landlord") appeals from an order of the District Court affirming the Bankruptcy Court's denial of its motion to dismiss for lack of good faith. The Landlord contends that the Debtor, Integrated Telecom Express, Inc. ("Integrated"), was never in financial distress and that the petition in this case was instead filed to frustrate the Landlord's claims and to increase the distribution of the Debtor's estate to Integrated's shareholders at the Landlord's expense. These contentions are corroborated by the record. First, according to schedules filed with the Bankruptcy Court, Integrated had $105.4 million in cash and $1.5 million in other assets at the time that it filed for bankruptcy, and yet the Landlord's proof of claim lists the present discounted value of Integrated's lease obligations at approximately $26 million. Integrated's schedules also list miscellaneous liabilities of approximately $430,000. Thus Integrated was highly solvent and cash rich at the time of the bankruptcy filing. Even if the IPO class action claim, which was capped at $25 million with Integrated's liability limited to a $5 million reserve (the balance to be paid by insurance) was listed at its full alleged value, Integrated was still solvent at the time of filing. Second, in a smoking gun resolution approved by the Board, and notwithstanding its strong financial position, Integrated authorized a letter to the Landlord threatening that if it did not enter into a settlement of the lease in the amount of at

least $8 million, Integrated would file for bankruptcy so as to take advantage of § 502(b)(6), which sharply limits the amount that a landlord can recover in bankruptcy for damages resulting from the termination of a lease.

The issue on appeal is whether, on the facts of this case, a Chapter 11 petition filed by a financially healthy debtor, with no intention of reorganizing or liquidating as a going concern, with no reasonable expectation that Chapter 11 proceedings will maximize the value of the debtor's estate for creditors, and solely to take advantage of a provision in the Bankruptcy Code that limits claims on long-term leases, complies with the requirements of the Bankruptcy Code. We conclude that such a petition is not filed in good faith and will therefore reverse.

I.

Integrated was a supplier of software and equipment to the broadband communications industry. In the summer of 2000, Integrated negotiated a lease of real property in Silicon Valley with the Landlord. After several months of negotiation, during which the Landlord evaluated Integrated's business condition and reviewed the company's prospectus, Integrated and the Landlord executed a lease for a term of ten years beginning on February 23, 2001, with a monthly base rent of $200,000, increasing 5 percent annually. The Landlord was aware of the financial risks associated with Integrated's business and willingly accepted those risks.

2001 was a very poor year for Integrated. The market for many of the company's products deteriorated, causing

Integrated to suffer net losses of $36.2 million. Integrated hired a management and technology consulting firm in December 2001 to help evaluate Integrated's operating alternatives. Integrated also retained Lehman Brothers, an investment bank, in February 2002, to assist in identifying, soliciting, and evaluating proposals for a sale or merger of Integrated or its assets. Unable to find a third party willing to enter into such a transaction, and unable to identify an alternative business model, Integrated's Board of Directors prepared a plan for the liquidation and dissolution of the company under state law.

In November 2001, a securities class action styled *Richmon v. Integrated Telecom Express, Inc.*, No. 01-CV-10108-SAS, was filed in the Southern District of New York naming Integrated as a defendant, along with certain officers, directors, and underwriters of Integrated. The class consists of individuals who purchased Integrated stock between August 18, 2000, and December 6, 2000. The class action alleges claims in the amount of $93.24 million for various violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with Integrated's initial public offering of securities. Similar lawsuits concerning more than 300 other companies' initial public offerings have been filed and coordinated as *In re Initial Public Offering Securities Litigation*, No. 21-MC-00092-SAS (S.D.N.Y.).

On April 18, 2002, Integrated's Board approved a Plan of Complete Liquidation and Dissolution under Delaware law. The two major issues to be resolved prior to dissolution were (1) the disposition of Integrated's intellectual property rights and (2) its remaining obligations under the lease. In

Appendix A

May of 2002, the Board approved the sale of substantially all of Integrated's intellectual property and related assets to Real Com, a corporation to be formed by certain of Integrated's officers and directors. The proposed purchase price was $1.5 million plus assumption of Integrated's technical support and warranty obligations.

Thereafter, Integrated attempted to negotiate an accord and satisfaction of its lease. Integrated asserts that, "[d]uring this time, Debtor first became aware that it might use Chapter 11 to, among other things, address Landlord's claims." Appellee's Br. at 6-7. On August 13, 2002, the Board authorized a Chapter 11 filing in the event that the Landlord would not accept $8 million as an accord and satisfaction of Integrated's obligations under the lease. The minutes of the August 13 Board meeting state, in pertinent part:

> Mr. Regel [Integrated's CEO] updated the Board on his discussions with the landlord subsequent to the last board meeting. Mr. Regel noted that the landlord did not appear to believe that the Company would seriously consider making a bankruptcy filing.
>
> Ms. Murray [of the law firm Murray & Murray] next reviewed with the Board the draft letter to the landlord (a copy of which was previously distributed to the Board).
>
> Ms. Murray then reviewed with the Board the timeline .. . for a bankruptcy filing and related bankruptcy procedures.

Various members of the Board then asked questions of Ms. Murray related to the draft letter to the landlord and the procedures for, and implications of, a possible bankruptcy filing by the Company. A discussion among the Board ensued, including a discussion of the costs and potential benefits and risks of proceeding with a bankruptcy filing.

Following that discussion, Mr. Regel asked the Board for authority for management to negotiate a settlement with the landlord in an amount in the range of $6 to $7 million. A further discussion among the Board ensued regarding the costs associated with a bankruptcy filing and potential costs of any litigation. After additional discussion, the Board approved the following resolutions:

RESOLVED: That the officers of the Company are, and each of them hereby is, authorized and directed to send the landlord the letter prepared by Murray and Murray in substantially the form reviewed with the Board.

RESOLVED FURTHER: That the officers of the Company are, and each of them hereby is, authorized and directed to negotiate a settlement with the landlord up to a maximum settlement amount of $7 million.

RESOLVED FURTHER: That the Board hereby appoints . . . a special committee (the

"Committee") that is hereby empowered on behalf of the Board to authorize the officers of the Company to enter into a settlement with the landlord up to a maximum settlement amount of $8 million.

RESOLVED FURTHER: That the officers of the Company shall be required to seek approval from the Board prior to entering into an [sic] settlement with the landlord in excess of $8 million.

RESOLVED FURTHER: That the officers of the Company be, and each of them hereby is, authorized and directed to instruct bankruptcy counsel to begin to prepare the necessary paperwork for a bankruptcy filing.

RESOLVED FURTHER: That if the landlord is not willing to enter into a settlement agreement with a maximum amount of $8 million, then the officers of the Company shall be, and each of them hereby is, authorized and empowered on behalf of, and in the name of, the Company to execute and verify or certify a petition under Chapter 11 of the Bankruptcy Code and to cause the same to be filed in the appropriate United States Bankruptcy Court (the "Bankruptcy Court") at such time as said authorized officer executing the same shall determine.

On August 15, 2002, Integrated's bankruptcy counsel sent the Landlord a letter stating that, if the Landlord was

unwilling to settle, the Debtor was prepared to avail itself of various provisions in the Bankruptcy Code, including the cap on landlords' claims set forth in 11 U.S.C. § 502(b)(6).[1]

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1. 11 U.S.C. § 502(b)(6) limits the amount that a landlord can recover in bankruptcy for damages resulting from the termination of a lease. Under § 502(b)(6), a landlord can recover rent that has accrued as of the filing of the petition, but may not recover rent remaining on the lease beyond one year's rent or 15 percent of the remaining rent (not to exceed three years), whichever is greater:

> (a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects.
>
> (b) . . . if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –
>
> . . .
>
> (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –
>
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates. . . .

The letter asserted that "even if [Integrated] were to file bankruptcy solely to cap the Lessor's claim using Bankruptcy Code § 502(b)(6), a use for which this Code section is intended, [Integrated] would not violate the good faith filing doctrine."

No settlement was reached.

Proceedings in the Bankruptcy Court

Integrated filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on October 8, 2002. According to schedules filed with the Bankruptcy Court, Integrated had $105.4 million in cash and $1.5 million in other assets at the time that it filed for bankruptcy. The Landlord filed a proof of claim listing the present discounted value of Integrated's lease obligations at approximately $26 million. Integrated's schedules also list miscellaneous liabilities of approximately $430,000.

Immediately after Integrated filed its petition, Integrated attempted to address the two major obstacles to dissolution: the sale of its intellectual property assets and its remaining obligations under the lease. On October 9, 2002, the day after Integrated filed its petition, Integrated moved to sell its intellectual property assets at a public auction. The Official Committee of Equity Security Holders (the "OCESH") objected to the adequacy of Integrated's efforts to market the assets. Ultimately, Integrated was able to renegotiate the sale and to introduce other bidders. As a result, a new agreement was reached with Real Com for some, but not all, of the assets for $2 million, an increase of $500,000.

The remaining assets were sold for $500,000 after confirmation of the plan of reorganization.

Also on October 9, 2002, Integrated moved to reject the lease. The Landlord opposed the motion and, on October 28, 2002, filed a motion to dismiss the Chapter 11 proceeding on the ground that the petition was not filed in good faith. On January 8, 2003, the Bankruptcy Court conducted an evidentiary hearing on the motion to dismiss and the motion to reject the lease during which it heard evidence regarding Integrated's decision to file for Chapter 11. After the close of evidence, the Bankruptcy Court determined that oral argument was unnecessary and denied the motion to dismiss from the bench.

The Bankruptcy Court explained at the hearing that Integrated "offered a number of reasons for the filing of the bankruptcy case," and that the court "believe[d] there is validity to a number of those considerations." The court, however, did not expand on this statement except to stress that Integrated "was losing a lot of money." The court characterized the company's financial losses as "dramatic." According to the court, Integrated "was experiencing a dramatic downward spiral" in September 2001. As such, the court concluded that "the Board had an obligation, and appropriately exercised that obligation, to give the investors their money back."

Alternatively, the Bankruptcy Court held that, "even assuming" that Integrated's stated reasons for filing the petition were not "particularly persuasive," Integrated's desire to take advantage of the § 502(b)(6) cap on landlords' claims

was not a sufficient basis on which to dismiss the petition "as a matter of law":

> But even assuming that those other factors are not particularly persuasive, even assuming or accepting the landlord's position, particularly illustrated by the Board of Directors' minutes of August 13 of '02, that the principal reason for the Chapter 11 case was to cap the damage claim for the landlord, I conclude that as a matter of law, that is not a debilitating fact. I held in [*In re PPI Enterprises (U.S.), Inc.*, 228 B.R. 339 (Bankr.D.Del.1998), *aff'd*, 324 F.3d 197 (3d Cir. 2003)], and other cases have held, that it does not establish bad faith for a debtor to file a chapter 11 case for the purpose of taking advantage of provisions which alter pre-petition rights, including altering the rights of a landlord under State law.

The Bankruptcy Court was guided by the following proposition: "[A]s the case law clearly indicates, not limited to my case [referring to the Bankruptcy Judge's decision in *PPI*], the solvency of the debtor and the fact that the equity interest holders will receive a distribution does not serve as the basis for a finding of bad faith." The court thus saw no significance in the fact that the § 502(b)(6) cap would operate solely to the benefit of equity holders, as opposed to creditors:

> What I think is also significant in this case is that . . . this debtor had no significant debt. . . .

> The difference in this case is that the company was not at all leveraged. And if the distribution were, for the most part, or totally to go to the creditors, there would be no basis for the landlord to complain regarding some equitable principle.
>
> But I don't think the Code makes any distinction. And I think that the-why this case is different is because the debtor simply was not leveraged. And instead of the significant distribution going to debt holders . . . it's going to go to the shareholders.

The Bankruptcy Court then went on to discuss "other decisions that agree with that proposition, namely that a solvent debtor can avail itself of the 502(b)(6) cap," focusing in particular on *In re Sylmar Plaza, L.P.*, 314 F.3d 1070 (9th Cir. 2002), and characterizing *Sylmar* as "almost on all fours with the situation before me."

With respect to the equities of the case, the Bankruptcy Court found that, although the shareholders would realize a "benefit" from the bankruptcy in the form of a "significant distribution," "the shareholders are not coming out whole by any means." The court concluded that "obviously you can't consider that they [*i.e.*, the shareholders] are being treated [to] any windfall." Conversely, the court found that the Landlord elected to "ride with the bulls," when it entered into the lease with Integrated, and that, as a "sophisticated individual" who "took the risk [hoping] that his instincts were right," he must "suffer the consequences" of his instincts being wrong. On January 30, 2003, the Bankruptcy Court

issued an order formally denying the motion "for the reasons stated on the record at the Hearing."

The Bankruptcy Court Confirms Integrated's Plan of Liquidation

The Bankruptcy Court held a confirmation hearing on April 7, 2003, and issued an order confirming Integrated's proposed plan of liquidation over the Landlord's objections on April 16, 2003. Applying § 502(b)(6), the Landlord's claim was reduced from $26 million to $4.3 million. The plan of liquidation did not completely resolve the securities class action. Instead, the plan reserved $5 million of the debtor's estate to satisfy any judgment that might be entered in the securities class action. When added to $20 million in insurance coverage available to Integrated, the plan effectively limited any potential judgment in the securities class action to $25 million. The securities class voted in favor of the plan of liquidation.

The Landlord appealed to the District Court and moved the Bankruptcy Court to stay confirmation of the plan pending appeal. The Bankruptcy Court addressed the Landlord's motion for a stay at an April 29, 2003 hearing. The Bankruptcy Court reaffirmed its earlier ruling on the Landlord's motion to dismiss, making several "observations to amplify the record on the issue." Specifically, the Bankruptcy Court elaborated on the significance of the securities class action:

> There is nothing in the law to suggest that the corporation cannot avail itself to the distribution

scheme set forth in the Bankruptcy Code in effecting that liquidation. In that regard, it's also worth noting that [this] Chapter 11 case had the effect on the securities law plaintiffs similar to its effect on this landlord. It effectively reduced the recovery by the securities law claimants by treating them like shareholders pursuant to Section 510(b).[2]

Could the securities law plaintiffs obtain a bad faith ruling in this case? I don't think so for essentially the same reasons I think that the landlord cannot.

With respect to the securities law action, I am puzzled to understand how that claim could be resolved in a non-bankruptcy law liquidation context absent a final resolution of that claim. In a non-bankruptcy law context, the securities law plaintiffs would have had a very strategic advantage, namely so long as there was a possible recovery against the corporation, the liquidation would be stalled indefinitely.

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2. 11 U.S.C. § 510(b) subordinates claims for damages arising from the purchase or sale of a security of the debtor to all claims and interests that are senior or equal to the claim or interest represented by such security. Where, as here, the security is common stock, the claim has the same priority as common stock. *Collier on Bankruptcy* §§ 510.01, 510.04 [1] (15th ed.2004).

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The Bankruptcy Court also commented on Integrated's financial affairs leading up to its decision to file for Chapter 11:

> THE COURT: Are you saying that Integrated Telecom is a healthy company?
>
> MR. HAZELTINE: Your Honor, Integrated Telecom as it sits here today is a very healthy company. At the time it entered for bankruptcy it was a very healthy company. They had-
>
> THE COURT: They're out of business, aren't they?
>
> MR. HAZELTINE: They're out of business. But their balance sheet looks great. They have $105 million in assets, $28 million in debts if the landlord's claim is not capped. They could become an investment company, invest that money and make-make money. They just-
>
> THE COURT: Well, I-they could. But I believe they would be in breach of their fiduciary duty if they did, and I made this observation back in January.

The Bankruptcy Court nevertheless stayed its confirmation order pending appeal, on the condition that the Landlord post a $2.5 million bond.

Appendix A

Appeal to the District Court

The District Court affirmed, holding that the Bankruptcy Court did not abuse its discretion in denying the Landlord's motion to dismiss. The District Court concluded that the Bankruptcy Court made two specific findings of fact: (1) that in September 2001 the Debtor was in "financial distress"; and (2) that the Board, consistent with its fiduciary responsibility, properly pursued liquidation in order to fulfill its obligations to its investors. The District Court did not disturb either finding.

The District Court understood the Bankruptcy Court to have alternatively ruled, as a matter of law, that "even if the Debtor's principal reason for filing its Chapter 11 case was to cap the Landlord's damage claim, that alone was insufficient to establish bad faith." The District Court concluded that the Bankruptcy Court's legal ruling "was based on a sound interpretation of relevant case law from this and other jurisdictions, and does not constitute an abuse of discretion." The District Court rejected the Landlord's argument that "permitting a solvent corporation to invoke the landlord cap would permit an end run around a core principle of bankruptcy law, the 'absolute priority rule'-that is, that creditors must be paid in full before stockholders can retain equity interests for any purpose." Like the Bankruptcy Court, the District Court observed that insolvency is not a prerequisite to filing under Chapter 11. Regardless, in light of the Bankruptcy Court's finding that Integrated was "experiencing a dramatic downward spiral" and that filing a Chapter 11 petition fulfilled the Board's obligations to shareholders, the District Court concluded that no such "end

run" had taken place. Although the District Court affirmed the Bankruptcy Court's ruling, the District Court extended the Bankruptcy Court's stay of the confirmation order.

The Landlord filed a timely appeal from the District Court's order. We expedited the appeal and stayed the Bankruptcy Court's confirmation order pending the appeal. Jurisdiction in the District Court was proper under 28 U.S.C. § 158(a), and we exercise jurisdiction under 28 U.S.C. § 158(d). Although this Court's jurisdiction is over the decision of the District Court, 28 U.S.C. § 158(d), "review of the District Court's decision effectively amounts to review of the bankruptcy court's opinion in the first instance." *In re Hechinger Inv. Co. of Del.*, 298 F.3d 219, 224 (3d Cir. 2002).

II.

Chapter 11 bankruptcy petitions are subject to dismissal under 11 U.S.C. § 1112(b) unless filed in good faith, and the burden is on the bankruptcy petitioner to establish that its petition has been filed in good faith. *In re SGL Carbon Corp.*, 200 F.3d 154, 159-62 (3d Cir. 1999); *accord Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.)*, 324 F.3d 197, 211 (3d Cir. 2001) ("The debtor bears the burden of establishing good faith.").[3] Whether the good faith

3. Under 11 U.S.C. § 1112(b), "the court may convert a case under [Chapter 11] to a case under Chapter 7 ... or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause." The statute lists 10 non-exhaustive factors that may amount to cause. H.R.Rep. No. 95-595, at 406 (1977), (Cont'd)

requirement has been satisfied is a "fact intensive inquiry" in which the court must examine "the totality of facts and circumstances" and determine where a "petition falls along the spectrum ranging from the clearly acceptable to the patently abusive." *Id.* at 162. We therefore review for abuse of discretion the Bankruptcy Court's refusal to dismiss a Chapter 11 petition for want of good faith. *Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.)*, 324 F.3d 197, 211 (3d Cir. 2003). "[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *SGL Carbon*, 200 F.3d at 159 (quoting *ACLU v. Black Horse Pike Reg'l Bd. of Ed.*, 84 F.3d 1471, 1476 (3d Cir. 1996)).

At its most fundamental level, the good faith requirement ensures that the Bankruptcy Code's careful balancing of interests is not undermined by petitioners whose aims are antithetical to the basic purposes of bankruptcy:

> "[A good faith standard] furthers the balancing process between the interests of debtors and creditors which characterizes so many provisions of the bankruptcy laws and is necessary to legitimize the delay and costs imposed upon parties to a bankruptcy. Requirement [sic] of good faith prevents abuse of the bankruptcy process by

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(Cont'd)

reprinted in 1978 U.S.S.C.A.N. 5963, 6362 ("[The] list [contained in § 1112(b)] is not exhaustive. The court will be able to consider other factors as they arise, and to use its equitable powers to reach an appropriate result in individual cases.").

> debtors whose overriding motive is to delay creditors without benefitting them in any way. . . ."

SGL Carbon, 200 F.3d at 161-62 (quoting *Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1072 (5th Cir.1986)); *see also Carolin Corp. v. Miller*, 886 F.2d 693, 698 (4th Cir. 1989) (good faith requirement is "indispensable to proper accomplishment of the basic purposes of Chapter 11 protection"). The Supreme Court has identified two of the basic purposes of Chapter 11 as (1) "preserving going concerns" and (2) "maximizing property available to satisfy creditors." *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999); *accord Toibb v. Radloff*, 501 U.S. 157, 163-64 (1991) (discussing "the congressional purpose of deriving as much value as possible from the debtor's estate"). Each of these purposes informs our application of the good faith requirement:

> "Review and analysis of [the bankruptcy laws and relevant cases] disclose a common theme and objective [underlying the reorganization provisions]: avoidance of the consequences of economic dismemberment and liquidation, and the preservation of ongoing values in a manner which does equity and is fair to rights and interests of the parties affected. But the perimeters of this potential mark the borderline between fulfillment and perversion; between accomplishing the objectives of rehabilitation and reorganization, and the use of these statutory provisions to destroy

> and undermine the legitimate rights and interests of those intended to benefit by this statutory policy. That borderline is patrolled by courts of equity, armed with the doctrine of 'good faith'. . . ."

SGL Carbon, 200 F.3d at 161 (quoting *In re Victory Constr. Co., Inc.*, 9 B.R. 549, 558 (Bankr.C.D.Cal.1981), *order stayed Hadley v. Victory Constr. Co., Inc. (In re Victory Constr. Co., Inc.)*, 9 B.R. 570 (Bankr.C.D.Cal.1981)); *see also Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir.1994) ("The test is whether a debtor is attempting to unreasonably deter or harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis."); *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 808 F.2d 363, 373 (5th Cir. 1987) (en banc) (stating that if Chapter 11 plan does not have a rehabilitative purpose, the "statutory provisions designed to accomplish the reorganization objective become destructive of the legitimate rights and interests of creditors, the intended beneficiaries"); *Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762, 764 (1st Cir. 1991) (Breyer, J.) (stating that there must be "some relation-at least an arguable relation-between the chapter 11 plan and the reorganization-related purposes that the chapter was designed to serve").

Our cases have accordingly focused on two inquiries that are particularly relevant to the question of good faith: (1) whether the petition serves a valid bankruptcy purpose, *e.g.*, by preserving a going concern or maximizing the value of the debtor's estate, and (2) whether the petition is filed

merely to obtain a tactical litigation advantage. *SGL Carbon,* 200 F.3d at 165.

> It is easy to see why courts have required Chapter 11 petitioners to act within the scope of the bankruptcy laws to further a valid reorganizational purpose. Chapter 11 vests petitioners with considerable powers-the automatic stay, the exclusive right to propose a reorganization plan, the discharge of debts, etc.-that can impose significant hardship on particular creditors. When financially troubled petitioners seek a chance to remain in business, the exercise of those powers is justified. But this is not so when a petitioner's aims lie outside those of the Bankruptcy Code.

Id. at 165-66.[4] Likewise, "because filing a Chapter 11 petition

4. In *SGL Carbon,* we used the phrase "a valid reorganizational purpose" because that case involved a plan of reorganization. *See SGL Carbon,* 200 F.3d at 167. Reorganization, however, is not the only "appropriate use of Chapter 11 since the Code clearly contemplates liquidating plans under 11 U.S.C. § 1123(b)(4), whereby a debtor may develop a Chapter 11 plan to sell off all of its assets." *PPI,* 324 F.3d at 211; *accord* 11 U.S.C. § 1123(b)(4) ("[A] plan may . . . provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests. . . ."). Yet liquidation plans, no less than reorganization plans, must serve a valid bankruptcy purpose. That is, they must either preserve some going concern value, *e.g.*, by liquidating a company as a whole or in such a way as to preserve some of the company's goodwill, or by maximizing the value of the debtor's estate.

We therefore reject the OCESH's argument that the good faith inquiry applies with less force to liquidation plans because, since

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merely to obtain tactical litigation advantages is not within 'the legitimate scope of the bankruptcy laws,' courts have typically dismissed Chapter 11 petitions under these circumstances as well." *Id.* at 165 (quoting *In re Marsch,* 36 F.3d at 828); *see also Furness v. Lilienfield,* 35 B.R. 1006, 1013 (D.Md. 1983) ("The Bankruptcy provisions are intended to benefit those in genuine financial distress. They are not intended to be used as a mechanism to orchestrate pending litigation.").

A.

As the Bankruptcy Court recognized, Integrated is unquestionably "out of business," and therefore has no going concern value to preserve in Chapter 11 through reorganization or liquidation under the Bankruptcy Code. The question therefore becomes whether Integrated's petition might reasonably have "maximiz[ed] the value of the bankruptcy estate." *Toibb,* 501 U.S. at 163; *accord 203 N. LaSalle,* 526 U.S. at 453. For the reasons that follow, we conclude that it would not.

(Cont'd)

ownership is not allowed to retain an interest in the reorganized entity, the potential for bad faith is reduced. The good faith requirement is necessitated as much by the hardship of Chapter 11 to certain interests as it is by the benefit to others. *SGL Carbon,* 200 F.3d at 161-62, 165-66. Moreover, the facts of this case demonstrate the fallacy of the OCESH's argument. While the owners of Integrated may never recover the full value of their investments, they stand to reap a substantial gain through bankruptcy, at the expense of the company's sole creditor.

Appendix A

To say that liquidation under Chapter 11 maximizes the value of an entity is to say that there is some value that otherwise would be lost outside of bankruptcy. Elizabeth Warren, *Bankruptcy Policymaking In an Imperfect World,* 92 Mich. L.Rev. 336, 350 (1993) ("Two empirically based economic assumptions underlie the attempt to preserve the value of a failing company: (1) orderly liquidation is likely to produce more value-or to avoid more loss-than piecemeal liquidation; and (2) going-concern value is likely to be higher than liquidation value."); Collier on Bankruptcy ¶ 1108.12 ("[W]here liquidation is appropriate, the Code contemplates orderly liquidation and not a 'fire sale.'"). At its most basic level, the Bankruptcy Code maximizes value by alleviating the problem of financial distress. *See* Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* 10 (1986) ("The basic problem that bankruptcy law is designed to handle, both as a normative matter and as a positive matter, is that the system of individual creditor remedies may be bad for the creditors *as a group* when there are not enough assets to go around."). As Integrated conceded at oral argument, good faith necessarily requires some degree of financial distress on the part of a debtor. *See SGL Carbon,* 200 F.3d at 166 ("Courts, therefore, have consistently dismissed Chapter 11 petitions filed by *financially healthy* companies with no need to reorganize under the protection of Chapter 11." (emphasis added)); *Coastal Cable,* 709 F.2d at 765 ("To meet the 'good faith' requirement ... many courts have held that a reorganization plan must bear some relation to the statutory objective of resuscitating a *financially troubled* corporation." (emphasis added)); *Baker v. Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.),* 931 F.2d 222, 228 (2d Cir.1991) ("Although a debtor need not be *in extremis* in

order to file such a petition, it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future."); *In re Dixie Broad., Inc.*, 871 F.2d 1023, 1027 (11th Cir.1989) (recognizing that one factor relevant to good faith is "whether the debtor is 'financially distressed'" and affirming dismissal of petition for, *inter alia,* use of bankruptcy proceedings despite the apparent good financial health of the debtor"); *Little Creek,* 779 F.2d at 1072 ("Determining whether the debtor's filing for relief is in good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities."); *In re The Bible Speaks,* 65 B.R. 415, 424-26 (Bankr.D.Mass.1986) (concluding that, despite the absence of a statutory financial eligibility standard in Chapter 11, "[t]he legislative history [to the Bankruptcy Code] indicates that Congress intended Chapter 11 to be resorted to by business entities which are experiencing some type of financial difficulty"); *In re Talladega Steaks, Inc.*, 50 B.R. 42, 44 (Bankr.N.D.Ala.1985) (dismissing petition where debtor "presented no evidence that financial difficulties had precipitated the filing of the petition and indeed testified that the debtor's debts and other financial obligations were substantially current").

To be sure, a debtor need not be insolvent before filing for bankruptcy protection. *SGL Carbon,* 200 F.3d at 163-64.

> [T]he drafters of the Bankruptcy Code understood the need for early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation. Such encouragement, however, does not open the door

> to premature filing, nor does it allow for the filing of a bankruptcy petition that lacks a valid reorganizational purpose.

SGL Carbon, 200 F.3d at 163 (footnote omitted); *see also, e.g., In re Johns-Manville Corp.,* 36 B.R. 727, 736 (Bankr.S.D.N.Y.1984) ("Accordingly, the drafters of the Code envisioned that a financially beleaguered debtor with real debt and real creditors should not be required to wait until the economic situation is beyond repair in order to file a reorganization petition."). Saying that there is no insolvency requirement, however, does not mean that all solvent firms should have unfettered access to Chapter 11. Despite the absence of an express financial eligibility requirement in the Code,[5] *SGL Carbon* emphatically rejected any such proposition:

> Courts, therefore, have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11. Those courts have recognized that if a petitioner has no need to rehabilitate or reorganize, its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed.

SGL Carbon, 200 F.3d at 166 (citations omitted). Accordingly, the absence of a solvency requirement

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5. Integrated unquestionably meets the express statutory requirements for eligibility to file a Chapter 11 petition. 11 U.S.C. § 109(d); *The Bible Speaks,* 65 B.R. 415 at 424-25.

recognizes that even solvent firms can, at times, suffer from financial distress. *Id.* at 163 (early access for solvent debtors designed to preempt "a hopeless situation"); *In re Marshall,* 300 B.R. 507, 512-13 (Bankr.C.D.Cal.2003) ("It is not uncommon for debtors to be solvent under the balance sheet test, and yet to have severe financial problems. . . . The United States bankruptcy law is designed to provide relief from creditor pressures for debtors with cash flow difficulties, even where they are clearly solvent under a balance sheet test.").

Both the Bankruptcy Court and the District Court concluded that Integrated faced financial distress because it "was losing a lot of money," and "was experiencing a dramatic downward spiral" in September 2001, and that, as a result, Integrated had gone "out of business." We do not see how bankruptcy offers Integrated any relief from this sort of distress, which has no relation to any debt owed by Integrated. That is, we can identify no value for Integrated's assets that was threatened outside of bankruptcy by the collapse of Integrated's business model, but that could be preserved or maximized in an orderly liquidation under Chapter 11. Because Integrated's "dramatic downward spiral" does not establish that Integrated was suffering from financial distress, it does not, standing alone, establish that Integrated's petition was filed in good faith.

Creditors that fear an impending default may seek to protect their claims, triggering "the chaotic mix of self-help repossession and judicial execution available at state law" to which the Bankruptcy Code provides an alternative. Warren, *Bankruptcy Policymaking,* 92 Mich. L.Rev. at 350.

The absence of an insolvency requirement encourages companies to file for Chapter 11 before they face a financially hopeless situation. *SGL Carbon,* 200 F.3d at 163-64. Yet this is decidedly not the case here. The Bankruptcy Court recognized the unquestionable reality that "the debtor simply was not leveraged" and, apart from the Landlord's claim, "had no significant debt." JA34-35. The court's conclusion that "I don't think the Code makes any distinction" is legal error.

The absence of any financial distress facing Integrated distinguishes the two principal cases relied on by the Bankruptcy Court and the District Court. In *PPI,* an insolvent debtor defaulted on a lease with approximately $5.86 million in rent remaining on the lease. 324 F.3d at 200-01. The debtor's Chapter 11 petition purported to serve two main purposes: (1) liquidating the debtor's sole asset, namely, $12.6 million in stock in Del Monte Food Co., free of restrictions that would otherwise have limited its value to $1.6 million; and (2) limiting the landlord's lease termination damages under § 502(b)(6). *Id.* at 201 & n. 5. The debtor was successful on both fronts. The Del Monte stock was sold at a court-approved auction for $11 million, *id.* at 201 n. 5, and the landlord's lease claim was capped at $100,000, *id.* at 207.

Critically, the debtor in *PPI* claimed to have been insolvent. In addition to the landlord's claims, the debtor had unsecured claims of approximately $54.6 million, dwarfing the value of its only asset, the Del Monte stock. *PPI,* 228 B.R. at 343. The landlord in *PPI* objected to these claims because the debt was owed to insiders of the debtor,

namely, the debtor's parent companies. The landlord argued that these insider claims should be recharacterized as equity interests, which would leave the debtor solvent by approximately $11 million (not including the landlord's claim). *Id.* at 345. This issue, however, was not raised on appeal, and we proceeded on the assumption that the debtor "owed 50 million in 'inter-company debt.'" *PPI,* 324 F.3d at 200 n. 3. Accordingly, *PPI* stands for the proposition that an insolvent debtor can file under Chapter 11 in order to maximize the value of its sole asset to satisfy its creditors, while at the same time availing itself of the landlord cap under § 502(b)(6).

We likewise understand *In re Sylmar Plaza,* which the Bankruptcy Court considered "almost on all fours with the situation before me," to be a case in which Chapter 11 was used to maximize value for creditors. The debtors in *Sylmar Plaza* owned a shopping center that was subject to a secure loan from the bank. The debtors experienced "cash flow problems" and ultimately defaulted on the loan. 314 F.3d at 1072-73. Bankruptcy allowed the debtor to sell the shopping center free and clear of the bank's lien, which sale the Bankruptcy Court found to be in the best interest of the estate and all of its creditors. *Id.* at 1073; Supp.App. at 114 (Order Authorizing Sale of Real Property Free and Clear of Liens at 4, *In re Sylmar Plaza,* No. LA-99-33188- AA (Bankr.C.D.Cal. Nov. 24, 1999)).

The bank did not appeal the sale order. *Sylmar Plaza,* 314 F.3d at 1073. Instead, the Bank appealed from the confirmation of the debtor's plan of reorganization, which took advantage of a provision in the Bankruptcy Code to

calculate the bank's claim according to the regular interest rate, rather than the default interest rate. *Id.* In particular, the bank objected to the fact that "the plan leaves the [debtors] solvent while permitting them to avoid paying post-petition interest at the default interest rate." *Id.* at 1074.

The Ninth Circuit affirmed the lower court's finding of good faith, reasoning that (1) insolvency is not a prerequisite to a finding of good faith, and (2) the fact that a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding. *Id.* at 1074-75. The court's holding, however, cannot be divorced from the facts of that case, which reveal that the Bankruptcy Code was used to maximize value for creditors as a whole. Moreover, although the debtors appear to have come out solvent in *Sylmar Plaza,* there is no indication that they would have come out solvent had the bank's claim not been limited, or that solvency was a foregone conclusion when the petition was filed.

In contrast, as noted above and detailed below, according to schedules filed with the Bankruptcy Court, Integrated had $105.4 million in cash and $1.5 million in other assets at the time that it filed for bankruptcy, and yet the Landlord's proof of claim lists the present discounted value of Integrated's lease obligations at approximately $26 million. Integrated's schedules also list miscellaneous liabilities of approximately $430,000. Thus Integrated was highly solvent and cash rich at the time of the bankruptcy filing. Even if the IPO class action claim, which was capped at $25 million with Integrated's liability limited to a $5 million reserve (the balance to be paid by insurance) was listed at its full alleged value, Integrated was still solvent at the time of filing.

In light of the foregoing, we conclude that the collapse of Integrated's business model does not support a finding of good faith. Integrated was not suffering financial distress when it filed its petition, and the rulings of the Bankruptcy Court and the District Court to the contrary constitute legal error. The failure of Integrated's business did not subject the company to any pressure on the value of its assets that could be reduced or avoided in an orderly liquidation under Chapter 11. Because Integrated's economic difficulties do not establish that Integrated was suffering from financial distress, they do not, standing alone, establish that Integrated's petition was filed in good faith.

B.

On appeal, Integrated argues that its petition served a valid bankruptcy purpose because bankruptcy "provide[d] a framework for the Debtor to resolve the Securities Class Action." Appellee's Br. at 8. In this regard, the Bankruptcy Court made no findings that are entitled to deference. Instead the Bankruptcy Court merely acknowledged that Integrated "offered a number of reasons for the filing of the bankruptcy case" and that the court "believe[d] there is *validity to a number* of those considerations." (Emphasis added). "[A] number of those considerations" necessarily is less than *all* of those considerations, and the Bankruptcy Court did not identify which particular considerations had merit except to stress that Integrated "was losing a lot of money." Moreover, colloquially at least, stating that "there is validity to" something is not the same as saying that something is valid.

Nevertheless, Integrated bore the burden of demonstrating good faith, and there is no evidence in the record from which a finding of good faith could be made based on the pending securities class action. There is no question, for example, that the securities class action did not place Integrated in financial distress. When it filed its petition, Integrated had assets of nearly $107 million (of which $105 million was cash). Integrated also had Directors and Officers ("D & O") insurance coverage of $20 million. Although the securities class claimed $93 million, Integrated concedes in its brief that it "believed that the Securities Claim would be settled, likely within policy limits [*i.e.*, for less than $20 million]." Appellee's Br. at 33. In documents filed with the SEC, including a proxy statement issued in anticipation of a vote on Integrated's Plan of Complete Liquidation and Dissolution under Delaware law, Integrated stated:

> The company believes that the claims against it are without merit and intends to defend this lawsuit vigorously. While the outcome of these claims is currently not determinable, the Company does not expect that the ultimate costs to resolve these claims will have a material adverse effect on the Company's financial position, results of operations or cash flows.

James G. Regel, Integrated's CEO, testified that the above statement was true when the proxy statement was filed. Integrated offers no argument that circumstances surrounding the securities class action changed between April of 2002, when the Board resolved to liquidate under state law, and

October of that year, when the Board decided to file under Chapter 11.

In the end, Integrated's predictions proved accurate. The securities class ultimately voted in favor of a plan of liquidation that capped their claims at $25 million. Although the plan does not resolve the securities claims, it limits Integrated's liability for the securities class action to a $5 million reserve. The securities class action will go forward, but the class has essentially capped its recovery at $25 million (the $5 million reserve plus the $20 million D & O policy). The inescapable conclusion from the record is that the securities class action did not threaten any value of Integrated that Chapter 11 seeks to preserve. This case is therefore entirely distinguishable from cases such as *Johns-Manville,* where the debtor faced "approximately 16,000 lawsuits pending as of the filing date," with the prospect of the "filing of an even more staggering number of suits over the course of 20-30 years," 36 B.R. at 729, or *The Bible Speaks,* where the debtor experienced "two types of financial difficulty: a cash flow problem which prevent[ed] it from meeting its current obligations" and a "staggering" claim that "may well exceed the value of the Debtor's assets" and that "pose[d] a threat to the Debtor's continued existence," 65 B.R. at 426. *See SGL Carbon,* 200 F.3d at 168-69 (discussing these cases).[6]

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6. We further note that, given the $105 million in cash held by Integrated and the $20 million in D & O coverage, Integrated would have remained solvent even if the securities class and the Landlord were to recover the full value of their claims ($93 million and $26 million, respectively).

At the April 29 hearing, the Bankruptcy Court suggested that the bankruptcy process facilitated the liquidation of the securities class action. First, the Court reasoned that Chapter 11 "effectively reduced the recovery by the securities law claimants by treating them like shareholders pursuant to Section 510(b)." We cannot find any evidence in the record to support a finding that this treatment forced the securities class to accept the $25 million limit that the plan places on their potential recovery. Nor could counsel for Integrated and the OCESH support this finding when it was raised at oral argument.

Second, the Bankruptcy Court observed that, "[i]n a non-bankruptcy law context, the securities law plaintiffs would have had a very strategic advantage, namely so long as there was a possible recovery against the corporation, the liquidation would be stalled indefinitely." While the causal connection here may be more compelling, we fail to see how this observation distinguishes the securities class from any other typical creditor, since creditors often have strategic advantages outside of bankruptcy that they lack inside bankruptcy.

Regardless, neither of the Bankruptcy Court's observations establishes that Integrated suffered financial distress, and neither supports a finding that liquidation under Chapter 11 offered a reasonable chance of maximizing the value available to satisfy all of the parties with an interest in Integrated's estate. Rather than pursuing a valid bankruptcy purpose, these observations suggest that Integrated filed for Chapter 11 in part to gain a litigation advantage over the securities class, a use of Chapter 11 that we emphatically

rejected in *SGL Carbon*. 200 F.3d at 167 (holding that petition was not filed in good faith where debtor's sole purpose was "to put pressure on [a claimant] to accept the company's settlement terms").

C.

Integrated argues that its petition served three additional purposes that support a finding of good faith. As with the securities class action, the Bankruptcy Court did not specify which, if any, of these asserted justifications had merit. Our own review of the record convinces us that none of Integrated's proffered justifications warrant a finding of good faith.

First, Integrated argues that Chapter 11 "provide[d] an efficient procedure for the dissolution of Debtor and distribution of its assets to parties in interest." Appellee's Br. at 8. In the same vein, the OCESH argues that "[t]he Debtor's Chapter 11 filing was in good faith [because] the debtor utilized the liquidation provisions under Chapter 11 of the Bankruptcy Code for the proper purpose of obtaining a quick, efficient, and orderly winding down of the operations of its failed business." OCESH Br. at 7. Dissolution, however, is not an objective that can be attained in bankruptcy. Collier on Bankruptcy § 727.01[3] ("After liquidation, any dissolution of the corporation or partnership that the parties desire must be effectuated under state law, since the Code does not provide for dissolution of corporations or partnerships."). Nor is "distribution," standing alone, a valid bankruptcy purpose. Instead, the Bankruptcy Code allows for a distribution of the debtor's estate pursuant to a valid

plan of reorganization or liquidation. 11 U.S.C. § 1123. Antecedent to any such distribution is an inquiry whether the petition and the plan are filed in good faith, *i.e.*, whether they serve a valid bankruptcy purpose. Neither Integrated nor the OCESH offer any authority that the Code can be used to effectuate a liquidation that has no hope of maximizing the value of the company, *203 N. LaSalle,* 526 U.S. at 453; *Toibb,* 501 U.S. at 163, but simply facilitates dissolution on terms favorable to equity interests. Moreover, neither Integrated nor the OCESH have identified any efficiencies that were realized in this bankruptcy that could not have been realized under Delaware law.

Second, Integrated argues that Chapter 11 "provide[d] court oversight to the proposed sale of its intellectual property [as well as] certain protections to the parties [to the sale] not available outside of Chapter 11." Appellee's Br. at 8. Integrated's intellectual property assets consist of patents, trademarks, copyrights, and trade secrets related to the company's products and services. There is no dispute that the sale of these assets during the bankruptcy realized an additional $1 million beyond the sale that Integrated had negotiated prior to filing its Chapter 11 petition. Under the circumstances of this case, however, this fact hardly justifies invocation of Chapter 11.

For one, the increase in value was a result of Integrated's failure to adequately market the assets to potential bidders outside of the Board and management.[7] When, on the very

7. Although Integrated suggests that the increase in value was realized because "the Bankruptcy Code afforded Debtor and the buyer (Cont'd)

next day after it filed its petition, Integrated moved to sell the assets at auction without further marketing, the OCESH challenged Integrated's sale as an improper exercise of business judgment. True, the OCESH is "a creature of the Bankruptcy Code," Appellee's Br. at 31, and, but for Integrated's petition, the OCESH would not have existed. But surely Integrated did not need Chapter 11 to discover that a more open and competitive auction might increase the price obtained for its assets.

Moreover, the increase in value was relatively insignificant, representing less than one percent of Integrated's total assets. Integrated's *de minimis* assets (office equipment, inventory, etc.), by comparison, totaled $500,000. Further, the net gain to Integrated's estate must also consider the fees paid from the estate to the OCESH's committee members, attorneys, and professionals. In the end, this case is a far cry from *PPI,* where an *insolvent* debtor used Chapter 11 to *increase* the value of its sole asset by over 600 percent ($1.6 million to $11 million). That bankruptcy allowed for an additional $10 million to be paid to the creditors of the debtors. *PPI,* 324 F.3d at 201 & n. 5.

(Cont'd)

protections including the ability to sell free and clear of liens and claims, *see* section 363(f), and specific evidentiary 'good faith purchaser' findings, *see* section 363(m)," Appellee's Br. at 30, the record provides no support for this assertion. For the most part, the assets were sold to the same insiders with whom Integrated had already negotiated a sale prior to filing for Bankruptcy. The fact that these insiders were willing to purchase the assets outside of bankruptcy undercuts any argument that the protections of the Code affected the purchase price.

Finally, Integrated argues that Chapter 11 "enable[d] the Debtor to establish a bar date and define the universe of claims against it to assure that any distributions to its creditors and stockholders account for any inchoate claims." Appellee's Br. at 8. Essentially, Integrated argues that, through the OCESH, shareholders were able to investigate potential claims and determine that none existed. The Bankruptcy Court made no finding that Integrated was subject to "inchoate" claims that needed to be liquidated or barred, and Integrated's vague and passing references to potential disputes with its shareholders is entirely insufficient to establish a good faith expectation that Chapter 11 protection was necessary to protect Integrated from such claims.

D.

Having determined that Integrated was not in financial distress, and having rejected Integrated's post hoc rationalizations for filing under Chapter 11, we turn to the OCESH's argument that Integrated's desire to take advantage of the cap on landlord claims provided by § 502(b)(6) establishes good faith in and of itself. Integrated makes a similar argument when it states that its petition properly sought "a favorable forum for the consideration and resolution of other disputed claims, including the Landlord's claim." Appellee's Br. at 8.

The Bankruptcy Court did not hold that Integrated's desire to take advantage of the § 502(b)(6) cap established *good* faith. Instead, the Bankruptcy Court held that "it does not establish *bad* faith for a debtor to file a chapter [11] case for the purpose of taking advantage of provisions which alter

pre-petition rights, including altering the rights of a landlord under State law." (Emphasis added). We agree. Indeed, we believe it to be a truism that it is not bad faith to seek to avail oneself of a particular protection in the Bankruptcy Code-Congress enacted such protections with the expectation that they would be used. *In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir.1992) ("It is not bad faith to seek to gain an advantage from declaring bankruptcy-why else would one declare it?").

The far more relevant question is whether a desire to take advantage of a particular provision in the Bankruptcy Code, standing alone, establishes *good* faith.[8] We hold that it does not. Just as a desire to take advantage of the protections of the Code cannot establish *bad* faith as a matter of law, that desire cannot establish *good* faith as a matter of law. Given the truism that every bankruptcy petition seeks some advantage offered in the Code, any other rule would eviscerate any limitation that the good faith requirement places on Chapter 11 filings.

At least one Bankruptcy Court has dismissed for a lack of good faith a Chapter 11 petition seeking primarily to cap a landlord's claim for future rent under § 502(b)(6), *In re Liberate Technologies*, No. 04-31394-TC, 2004 WL

8. The law is clear that the burden is on the bankruptcy petitioner to establish that its petition has been filed in good faith. *PPI*, 324 F.3d at 211; *SGL Carbon*, 200 F.3d at 162 n. 10. The Bankruptcy Court's statements that "it does not establish bad faith for a debtor to," or "I conclude that as a matter of law, that is not a debilitating fact," erroneously suggest that the question before the court was whether bad faith, rather than good faith, had been proven.

2008956, at *7-*8 (Bankr. N.D. Cal. Sept. 8, 2004), and other Bankruptcy Courts have similarly dismissed Chapter 11 petitions filed merely to take advantage of other singular provisions of the Bankruptcy Code. *See N.W. Place, Ltd. v. Cooper (In re N.W. Place, Ltd.)*, 73 B.R. 978, 982 (Bankr.N.D.Ga.1987) (Chapter 11 petition filed to invoke trustee's avoidance powers under Bankruptcy Code and to set aside transfer); *In re S. Cal. Sound Sys., Inc.*, 69 B.R. 893, 900 (Bankr.S.D.Cal.1987) (Chapter 11 petition filed to reject executory contract pursuant to 11 U.S.C. § 365(a)); *In re Cardi Ventures, Inc.*, 59 B.R. 18, 22-23 (Bankr.S.D.N.Y.1985) (Chapter 11 petition filed to assume and assign lease pursuant to 11 U.S.C. § 365(f)); *In re Nancant, Inc.*, 8 B.R. 1005, 1008 (Bankr.D.Mass.1981) (Chapter 11 petition filed to have certain tax liability determined pursuant to 11 U.S.C. § 505). For example, 11 U.S.C. § 362 protects debtors by staying litigation against them during the pendency of the bankruptcy. Yet courts universally demand more of Chapter 11 petitions than a naked desire to stay pending litigation. *E.g., Dixie Broad.*, 871 F.2d at 1026-27. As one Bankruptcy Court put it:

> The protection of the automatic stay is not *per se* a valid justification for a Chapter 11 filing; rather, it is a consequential benefit of an otherwise good faith filing. A perceived need for the automatic stay, without more, cannot convert a bad faith filing to a good faith one.

In re HBA East, Inc., 87 B.R. 248, 262 (Bankr.E.D.N.Y.1988). Indeed, if there is a "classic" bad faith petition, it may be one in which the petitioner's only goal is to use the automatic stay provision to avoid posting an appeal bond in another court. *E.g., Marsch*, 36 F.3d at 828.

Integrated and the OCESH may therefore be correct that § 502(b)(6) reflects a Congressional determination that landlords stand to receive a windfall in a bankruptcy, and that landlord claims are inherently speculative. Furthermore, Integrated and the OCESH may be correct that § 502(b)(6) should operate to cap landlord claims, even where the only effect of the cap would be to transfer assets from creditors to equity holders.[9] Yet § 502(b)(6) and the legislative policy underlying that provision assume the existence of a valid bankruptcy, which, in turn, assumes a debtor in financial distress. The question of good faith is therefore antecedent to the operation of § 502(b)(6).

Although the Bankruptcy Code contains many provisions that have the effect of redistributing value from one interest group to another, these redistributions are not the Code's *purpose.* Instead, the purposes of the Code are to preserve going concerns and to maximize the value of the debtor's estate. *203 N. LaSalle,* 526 U.S. at 453; *Toibb,* 501 U.S. at 163-64. Section 502(b)(6) is precisely the sort of provision this Court had in mind when we stated:

> It is easy to see why courts have required Chapter 11 petitioners to act within the scope of the bankruptcy laws to further a valid reorganizational purpose. Chapter 11 vests petitioners with considerable powers – the automatic stay, the exclusive right to propose a reorganization plan, the discharge of debts, etc.-that can impose significant hardship on particular creditors. When

9. The Landlord and Amici vigorously argue that § 502(b)(6) does not apply to a solvent debtor.

> *financially troubled* petitioners seek a chance to remain in business, the exercise of those powers is justified. But this is not so when a petitioner's aims lie outside those of the Bankruptcy Code.

SGL Carbon, 200 F.3d at 165 (emphasis added). To be filed in good faith, a petition must do more than merely invoke some distributional mechanism in the Bankruptcy Code. It must seek to create or preserve some value that would otherwise be lost-not merely distributed to a different stakeholder-outside of bankruptcy. This threshold inquiry is particularly sensitive where, as here, the petition seeks to distribute value directly from a creditor to a company's shareholders. *See In re Telegroup Inc.,* 281 F.3d 133, 140 (3d Cir.2002) (quoting Elizabeth Warren, *Bankruptcy Policy,* 54 U. Chi. L.Rev. 775, 792 (1987), for the proposition that "[a]n almost axiomatic principle of business law is that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse-up to the full amount of their investment"); *see also 203 N. LaSalle,* 526 U.S. at 453 (characterizing one of the purposes of Chapter 11 as "maximizing property available *to satisfy creditors"*).

As we have explained above, in a smoking gun resolution approved by the Board, and notwithstanding its strong financial position, Integrated authorized a letter to the Landlord threatening that if it did not enter into a settlement of the lease in the amount of at least $8 million, Integrated would file for bankruptcy so as to take advantage of § 502(b)(6), which sharply limits the amount that a landlord can recover in bankruptcy for damages resulting from the termination of a lease.

Taken to its logical conclusion, the OCESH's argument is that any entity willing to undergo Chapter 11 proceedings may cap the claims of its landlord. Nothing in the Bankruptcy Code or its legislative history suggests that § 502(b)(6) was meant to allow tenants to avoid their leases whenever the landlord's state law remedy exceeds the cap under § 502(b)(6) by an amount greater than the cost of proceeding through a Chapter 11 reorganization or liquidation. Such a rule would not only obviate the need for a good faith requirement, but would be antithetical to the structure and purposes of the Bankruptcy Code.

III.

We hold that both the District Court and the Bankruptcy Court erred as a matter of law in concluding that Integrated suffered financial distress. Although Integrated's business model had failed, the company had no significant debt apart from the Landlord's claim. Moreover, the record demonstrates that the securities class action did not present a significant threat to Integrated's finances. Because Integrated was not in financial distress, its Chapter 11 petition was not filed in good faith as it could not-and did not-preserve any value for Integrated's creditors that would have been lost outside of bankruptcy. We will therefore reverse the order of the District Court affirming the Bankruptcy Court's denial of the Landlord's motion to dismiss, and will remand this case to the Bankruptcy Court with instructions to dismiss Integrated's petition.

APPENDIX B — MEMORANDUM ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE FILED MAY 19, 2004

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Bankruptcy Case No. 02-12945 (PJW)
Chapter 11

Civil Action No. 03-236-KAJ
(Consolidated with 03-494-KAJ)

In re: Integrated Telecom Express, Inc.,

Debtor.

NMSBPCSLDHB L.P.,

Appellant,

v.

INTEGRATED TELECOM EXPRESS, INC. and the Official Committee of Equity Holders, et al.,

Appellees.

MEMORANDUM ORDER

I. INTRODUCTION

Presently before me is a consolidated appeal by NMSBPCSLDHB L.P. (the "Landlord" or "Appellant") from

a January 30, 2003 Order by the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") denying the Landlord's Motion to Dismiss and an April 16, 2003 Order confirming the Debtor's[1] Second Amended Plan of Liquidation under Chapter 11. (Docket Item ["D.I."] 30.) Also before me is the Landlord's Motion to Extend the Stay of the Confirmation Order Pending Appeal.[2] (D.I. 50; the "Motion".) Jurisdiction is proper under 28 U.S.C. § 158. For the reasons that follow, the decisions of the Bankruptcy Court that are the subject of this appeal are affirmed and the Landlord's Motion will be granted.

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1. The Debtor is Integrated Telecom Express, Inc. Also named as an Appellee is The Official Committee of Equity Security Holders of Debtor Integrated Telecom Express, Inc. (the "Committee"), which was appointed by the Office of the United States Trustee for the District of Delaware on October 30, 2002. (D.I. 34 at 10.) Both the Debtor and the Committee filed briefs in opposition to the Landlord's appeal. (*See* D.I. 32, D.I. 34.) For simplicity, any reference to the Debtor in this Memorandum Opinion is understood to include the Committee.

2. Also before me is the Landlord's Motion to Expedite Appeal (D.I.40), which was denied during a November 24, 2003 teleconference. (*See* Tr. from 11/24/2003 teleconference at 7:5-8:5.)

Appendix B

II. BACKGROUND[3]

1. *Procedural Background*

Debtor filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code on October 8, 2002. (D.I. 30 at 4; D.I. 34 at 4.) On October 28, 2002, the Landlord moved to dismiss the Debtor's case on the ground that it was filed in bad faith. (*Id.*) The Bankruptcy Court held an evidentiary hearing on the Motion to Dismiss on January 8, 2003 and, on January 30, 2003, entered an order denying the motion. (*Id.*) Within ten days of filing its petition, the Debtor also filed a Plan of Liquidation, shortly followed by a Second Amended Plan of Liquidation (the "Plan") on February 5, 2003. (*Id.*) Landlord filed objections to confirmation of the Debtor's Plan, which were overruled by the Bankruptcy Court. (D.I. 30 at 5.) On April 16, 2003, the Bankruptcy Court entered an order confirming the Plan (the "Confirmation Order"). (*Id.*)

Also on April 16, 2003, the Landlord filed a motion to stay the Confirmation Order pending appeal. (D.I. 34 at 4.)

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3. The factual and procedural background set forth herein is, unless otherwise noted, largely undisputed. Much of the factual background is culled from the Bankruptcy Court hearing transcripts, which are reproduced in appendices submitted by the parties. (*See* D.I. 33, 35-38.) Rather than referring to the pagination in the appendices, I will cite the Bankruptcy Court hearing transcripts as "Tr." along with the date on which the hearing took place and the page number of the transcript (e.g., 1/8/03 Tr. at __). The Bankruptcy Court held hearings on the various motions on January 8, 2003; March 25, 2003; April 7, 2003; and April 29, 2003.

Appendix B

The Bankruptcy Court entered an order staying the Confirmation Order until April 30, 2004, provided that the Debtor maintain certain reserves in connection with the Landlord's claim, which would be required only if the Landlord posted an appropriate bond as part of its taking an appeal. (*Id.*) Once the Landlord posted the bond, the Debtor was forbidden from distributing or otherwise using the reserve amounts (approximately $23 million) until April 30, 2004. (*Id.* at 5.) The Landlord posted the bond amount on May 30, 2003, and on June 6, 2003, the Debtor made an initial distribution to its creditors and equity security holders, pursuant to the Plan. (*Id.*)

The Landlord filed timely appeals from the January 30, 2003 Order denying its motion to dismiss and the April 16, 2003 Confirmation Order. (D.I. 30 at 4,5.) On June 11, 2003, the parties stipulated to consolidation of the Landlord's appeals. (*Id.* at 5.)

2. *Factual Background*

Beginning in 1997, the Debtor was a supplier to the broadband access communications equipment industry. (D.I. 30 at 5; D.I. 34 at 5.) The Debtor's products included integrated circuits and software that enabled communications equipment manufacturers to provide asymmetric digital subscriber line ("ASDL") equipment to communications service providers and their customers. (*Id.*) The Debtor made an initial public offering ("IPO") of its stock on August 17, 2000, selling approximately 6 million shares at $18 per share, thus raising about $110 million. (D.I. 34 at 6.)

Appendix B

In the summer of 2000, the Debtor and the Landlord[4] began negotiating for a lease of real property located at 400 Race Street, San Jose, California (the "Race Street Property"), in the Silicon Valley. (D.I. 30 at 5- 6; D.I. 34 at 6.) The real estate market in the Silicon Valley was very active at that time, and many landlords in the area were able to command ten-year leases on their properties. (D.I. 30 at 6.) Robert Granum, the Landlord's principal and representative, negotiated the lease over several months with Bob Gardner, the Debtor's Chief Operating Officer at the time. (*Id.;* D.I. 34 at 6.) On September 21, 2000, the Landlord and the Debtor entered into a lease for the Race Street Property. (*Id.*) The lease, pertaining to 48,000 square feet of rentable space at the Race Street Property, was for a ten year term beginning on February 23, 2001, with a monthly base rent of approximately $200,000, increasing 5% annually. (D.I. 30 at 7; D.I. 34 at 6.)

Unfortunately for the Debtor, the market for ASDL equipment deteriorated rapidly, beginning in early 2001. (D.I. 34 at 7.) The decline was attributed to a worldwide slowdown in the communications industry, and, in particular, a reduced demand for the Debtor's products in Asia. (*Id.* at 7-8.) The Debtor's net loss for 2001 was $36.2 million. (*Id.* at 7.) As a result, the Debtor hired Booz Allen Hamilton, a management and technology consulting firm in December 2001, to help the Debtor evaluate its operating alternatives. (*Id.* at 8.) The Debtor also hired Lehman Brothers, an

4. At the time of the negotiations, the Landlord's name was "Granum Holdings." (D.I. 30 at 5-6; D.I. 34 at 6.) Only the Landlord's name, and not its identity, has changed. (D.I. 30 at 5 n. 2; D.I. 34 at 7 n. 3.)

investment bank, in February 2002, to assist in identifying, soliciting, and evaluating proposals for a sale or merger of the Debtor or its assets. (*Id.*) Unable to find a third party willing to enter into such a transaction, the Debtor's Board of Directors (the "Board") began discussing a plan for the Debtor's liquidation and dissolution. (*Id.* at 9.)

During an April 18, 2002 meeting, the Board approved a Plan of Complete Liquidation and Dissolution, under Delaware law. (D.I. 30 at 7; D.I. 34 at 9.) Thereafter, the Debtor and the Landlord attempted to reach a settlement regarding termination of the Race Street Property lease. (D.I. 30 at 7-8; D.I. 34 at 9.) During an August 13, 2002 meeting, the Board authorized a Chapter 11 filing if the Landlord would not enter into a settlement agreement with a maximum settlement amount of $8 million with the Debtor. (D.I. 30 at 9; D.I. 34 at 9.) On August 15, 2002, the Debtor's bankruptcy counsel sent the Landlord a letter notifying it that, if the Landlord was unwilling to settle, the Debtor was prepared to avail itself of various provisions of the Bankruptcy Code, including the cap on landlords' claims set forth in § 502(b)(6).[5] (*Id.* at 10.) Ultimately, the Landlord

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5. Section 502(b)(6) provides, in relevant part:

> Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—
>
> * * *

(Cont'd)

and the Debtor were unable to reach an agreement, (D.I. 30 at 9; D.I. 34 at 9), and the Debtor filed for bankruptcy under Chapter 11 on October 8, 2002 (D.I. 30 at 10; D.I. 34 at 10.) The Landlord asserts that, at the time the Debtor filed its petition, it had $105.4 million in cash and other assets worth approximately $1.5 million, and that the present discounted value of the Debtor's remaining lease obligations to the Landlord was approximately $26 million.[6] (*Id.*)

(Cont'd)

> (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—
>
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates[.]
>
> * * *

11 U.S.C. § 502(b)(6) (2004).

6. Apart from this indebtedness, the Debtor's other potential liability was a securities class action lawsuit filed in November 2001 in the Southern District of New York, and naming Debtor as a defendant. (D.I. 30 at 10-11; D.I. 34 at 7.) The case was filed on

(Cont'd)

Appendix B

On October 28, 2002, the Landlord filed a Motion to Dismiss the Debtor's Chapter 11 case (the "Motion to Dismiss"), arguing that the Debtor filed its bankruptcy petition in bad faith. (D.I. 30 at 12; D.I. 34 at 12.) The Bankruptcy Court held an evidentiary hearing on the Motion to Dismiss on January 8, 2003. (D.I. 30 at 12; D.I. 34 at 12-13.)

3. *The Bankruptcy Court's Ruling on the Landlord's Motion to Dismiss*

At the conclusion of the January 8, 2003 evidentiary hearing, the Bankruptcy Court issued a ruling denying the Landlord's Motion to Dismiss. (1/8/2003 Tr. at 123:13-19.) The Bankruptcy Court stated that, "as the case law clearly indicates, not limited to my case, *PPI* case,[7] the solvency of the debtor and the fact that the equity interest holders will receive a distribution does not serve as the basis for a finding of bad faith. . . ." (*Id.*) The Bankruptcy Court also discussed the evidence presented at the hearing, and made specific findings of fact based on that evidence. (*See id.* at 124-129.)

(Cont'd)
behalf of a class of people who purchased the Debtor's common stock between August 18, 2000 and December 6, 2000, asserting claims based on violations of several provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934 against certain underwriters, the Debtor, and its former officers and directors. (D.I. 34 at 7.)

7. The Bankruptcy Court was referring to *In re PPI Enters. (U.S.), Inc.*, 228 B.R. 339 (Bankr.D.Del.1998), *aff'd*, 324 F.3d 197 (3d Cir. 2003).

For example, the Bankruptcy Court found that the testimony of Mr. Granum, "a person very sophisticated in the real estate market[,] suggesting that he was sucked into a transaction" (*id.* at 123:20-25; 124:16-18) was "really difficult to accept . . ." (*id.* at 124:4). Furthermore, the Bankruptcy Court found that Mr. Granum elected to "ride with the bulls" when entering into the Race Street Property lease with the Debtor, and, as a "sophisticated individual" who "took the risk .. . hop[ing] that his instincts were right," he must "suffer the consequences" of his instincts being wrong. (*Id.* at 125:5-10.)

The Bankruptcy Court noted that the Debtor "offered a number of reasons for the filing of the bankruptcy case," (*id.* at 125:18-20), and then went on to say the following:

> But even assuming that those other factors are not particularly persuasive, even assuming or accepting the landlord's position, particularly illustrated by the Board of Directors' minutes of August 13 of '02, that the principle reason for the Chapter 11 case was to cap the damage claim for the landlord, I conclude that as a matter of law, that is not a debilitating fact. I held in the *PPI,* and other cases have held, that it does not establish bad faith for a debtor to file a chapter case for the purpose of taking advantage of provisions which alter pre-petition rights, including altering the rights of a landlord under State law.

(*Id.* at 125:25-126:10.) The Bankruptcy Court then went on to discuss "three other decisions that agree with that

proposition, namely that a solvent debtor can avail itself of the 502(b)(6) cap,"[8] and focused in particular on *In re Sylmar Plaza,* 314 F.3d 1070 (9th Cir.2002), characterizing it as "almost on all fours with the situation before me." (*Id.* at 129:19-130:9.) Finally, the Bankruptcy Court stated that, in September 2001, the Debtor "was experiencing a dramatic downward spiral"[9] and that the Board was "absolutely right" in exercising "its fiduciary responsibility in pursuing a liquidation course of action" in order to fulfill its "obligation [] to give the investors their money back." (*Id.* at 133:8-134:2.) For all of these reasons, the Bankruptcy Court denied the Landlord's Motion to Dismiss.

III. STANDARD OF REVIEW

In reviewing the Bankruptcy Court's decision on appeal, I am required to apply a clearly erroneous standard of review to its findings of fact and a plenary standard to its legal conclusions. *See Flint Glass Workers Union v. Anchor Resolution Corp.,* 197 F.3d 76, 80 (3d Cir.1999). When reviewing mixed questions of law and fact, I must accept the Bankruptcy Court's "finding of historical or narrative facts unless clearly erroneous, but exercise [] 'plenary review of the [bankruptcy] court's choice and interpretation of legal precepts and its application of those precepts to the historical facts.'" *Mellon Bank, N.A. v. Metro Communications,*

8. These decisions are *In re Federated Dep't Stores, Inc.,* 131 B.R. 808 (S.D.Ohio 1991), *In re Farley,* 146 B.R. 739 (N.D.Ill.1992), and *In re Sylmar Plaza,* discussed *infra.*

9. The Bankruptcy Court also characterized the Debtor's "financial affairs" as "distressful." (1/8/03 Tr. at 136:23-24.)

Inc., 945 F.2d 635, 642 (3d Cir.1991) (quoting *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 101-02 (3d Cir.1981)).

The test in the Third Circuit for determining a debtor's good faith has a specific standard of review. It is based on the "totality of the circumstances" and is a "fact-intensive, case-by-case inquiry" committed to the sound discretion of the Bankruptcy Court and is reviewed under an abuse of discretion standard. *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197, 211-12 (3d Cir.2003). "[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *In re SGL Carbon Corp.*, 200 F.3d 154, 159 (3d Cir.1999); *see also Tamecki v. Frank (In re Tamecki)*, 229 F.3d 205, 207 (3d Cir.2000). "An abuse of discretion can occur when no reasonable person would adopt the . . . [lower] court's view." *Rode v. Dellarciprete*, 892 F.2d 1177, 1182 (3d Cir.1990).

IV. DISCUSSION

A. *The Landlord's Consolidated Appeal*

The Landlord frames the issue presented in this consolidated appeal as whether the Bankruptcy Court erred "in concluding that the Debtor .. . filed in good faith where, as here, a solvent Debtor filed a Chapter 11 petition solely to invoke the landlord cap of § 502(b)(6), without a reorganizational purpose or need to liquidate, and as a litigation tactic." (D.I. 30 at 3-4.) The Debtor asserts that the issues on appeal are whether the Bankruptcy Court abused

its discretion in determining that the Debtor's Chapter 11 case was filed in good faith and whether the Bankruptcy Court abused its discretion in determining that the Debtor's Plan was proposed in good faith.[10] (D.I. 34 at 3.) Therefore, the parties agree that the essential question before me is whether the Bankruptcy Court erred in determining that the Debtor met the good faith requirement that is an implicit prerequisite to filing under Chapter 11.[11] *See* 7 Collier on Bankruptcy § 1112.07 (15th ed.1996) ("the requirement of good faith has been held to be an implicit condition to the filing and maintenance of a bankruptcy case"). The Third Circuit has directed courts to consider the totality of the circumstances

10. The Landlord also raises the issues of whether the doctrine of impairment precludes it from having voting rights against the Plan and whether the Third Circuit's decision in *PPI Enters.*, 324 F.3d 197, is controlling authority with respect to its consolidated appeal, but concedes that its positions on both of these issues are foreclosed by the Third Circuit's *PPI Enters.* decision. (D.I. 30 at 34-35 n. 7.) The Landlord notes that it raised these issues in order to preserve them on appeal, (*id.*), and I need not consider them further, because I agree that the *PPI Enters.* case speaks directly to the Landlord's arguments.

11. As the Landlord reiterated in its reply brief, "the Landlord argues that this filing must be examined under the *good faith doctrine* and that permitting a solvent debtor to file for sole purpose of invoking the landlord cap violates this doctrine." (D.I. 39 at 7 (emphasis in original).) The Landlord also asserts that the Bankruptcy Court made a purely legal ruling at the January 8, 2003, and that it is therefore subject to the *de novo* standard of review. (D.I. 30 at 4.) I disagree, as the Third Circuit's decision in *PPI Enters.*, 324 F.3d at 211-12, is quite clear that the Bankruptcy Court's determination regarding the Debtor's good faith is reviewed under an abuse of discretion standard.

in assessing the good faith of a Chapter 11 petition. *PPI Enters.*, 324 F.2d at 211 (citing *SGL Carbon,* 200 F.3d at 165). Again, this assessment is reviewed for abuse of discretion. *Id.* For the following reasons, I find that the Bankruptcy Court did not abuse its discretion in denying the Landlord's Motion to Dismiss the Debtor's Chapter 11 petition on the ground that it was filed in bad faith.

"[N]o list is exhaustive of all the factors which could be relevant when analyzing a particular debtor's good faith." *SGL Carbon,* 200 F.3d at 166 & n. 10 (internal quotations omitted). In this case, the Bankruptcy Court made findings of fact based on the evidence presented at the January 8, 2003 hearing and considered the totality of the circumstances surrounding the Debtor's Chapter 11 filing—namely, that in September 2001 the Debtor was in financial distress (1/8/03 Tr. at 136:23-24) and that the Board, consistent with its fiduciary responsibility, properly pursued liquidation in order to fulfill its obligations to its investors (*id.* at 133:8-134:2). The Bankruptcy Court also noted that the Debtor advanced many other valid reasons for filing its bankruptcy case. (*Id.* at 125:19-21.) These findings, pertaining to the Debtor's good faith, are well-founded and do not constitute an abuse of discretion by the Bankruptcy Court.

The Bankruptcy Court also ruled that, even if the Debtor's principal reason for filing its Chapter 11 case was to cap the Landlord's damage claim, that alone was insufficient to establish bad faith. (*Id.* at 126:2-10.) In support of this finding, the Bankruptcy Court discussed at length the

Ninth Circuit's decision in *Sylmar Plaza.*[12] (*Id.* at 130:2-132:6.) The Bankruptcy Court noted that, in *Sylmar Plaza,* the Ninth Circuit relied upon *PPI Enters.,* 228 B.R. at 347, and, in factual circumstances that were "almost on all fours" with the instant case (1/8/03 Tr. at 129:19-130:9), agreed that it is not bad faith to take advantage of a particular provision of the Bankruptcy Code for the purpose of capping the amount of a creditor's claim. *Sylmar Plaza,* 314 F.3d at 1075. Furthermore, the *Sylmar Plaza* case rejected the creditors' argument, much like the Landlord's argument here, that insolvency is a prerequisite to a finding of good faith under the Bankruptcy Code. 314 F.3d at 1075-76; *see also PPI Enters.,* 228 B.R. at 344-45, *aff'd,* 324 F.3d at 211-12; *SGL Carbon,* 200 F.3d at 163, 164; *Farley,* 146 B.R. at 747 ("a debtor's solvency has no legal bearing on whether it may terminate the lease agreement"); *Federated Dep't Stores,* 131 B.R. at 817 ("[t]here is simply nothing in the plain language of § 502(b)(6) to suggest that a bankruptcy court may depart from the application of a cap on a lessor's claim any time the debtor is solvent"). Relying on this and other legal authority (*see* 1/8/03 Tr. at 133:2-5), the Bankruptcy Court denied the Landlord's Motion to Dismiss. This decision was based on a sound interpretation of relevant case law from this and other jurisdictions, and does not constitute an abuse of discretion by the Bankruptcy Court.[13] See *SGL Carbon,* 200 F.3d at 159.

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12. The Landlord did not address the *Sylmar Plaza* case in its opening or reply briefs. (*See generally* D.I. 30, D.I. 39.)

13. The Landlord also argues that the Debtor should have filed its petition under Chapter 7, as opposed to Chapter 11, and that its

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Finally, the Landlord argues that "permitting a solvent corporation to invoke the landlord cap would permit an end run around a core principle of bankruptcy law, the 'absolute priority rule'"—that is, that creditors must be paid in full before stockholders can retain equity interests for any purpose. (D.I. 30 at 20 (citing *In re Telegroup Inc.*, 281 F.3d 133, 139 (3d Cir.2002).) However, as already noted, insolvency is not a prerequisite to filing under Chapter 11. This argument is also without merit in light of the Bankruptcy Court's findings that the Debtor was "experiencing a dramatic downward spiral" in its business (1/8/03 Tr. at 133:8-134:2), that the Landlord knowingly took a risk when entering into the lease with the Debtor (*id.* at 125:5-10), and that the Board was correct in fulfilling its obligations to shareholders by filing a voluntary petition under Chapter 11 (*id.* at 133:8-134:2).

B. *The Landlord's Motion to Extend the Stay of the Confirmation Order Pending Appeal*[14]

On April 29, 2004, the Bankruptcy Court entered an order extending the stay of distribution until the earlier of

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failure to do so constitutes bad faith. (D.I. 30 at 27.) This argument is not well-founded, because even if the Debtor had failed for Chapter 7 protection, it still would have been able to benefit from § 502(b)(6). *See PPI Enters.*, 228 B.R. at 347 ("[Section] 502(b)(6) is not tethered to Chapter 11 cases. It applies equally to Chapter 7 cases.").

14. The Landlord's reply briefs to the Debtor's and the Committee's answering briefs are due on May 21, 2004 and May 24, 2004, respectively. However, because I find in favor of the Landlord with respect to its Motion, the reply briefs are unnecessary.

Appendix B

"(i) June 25, 2004, (ii) the date of entry of an order by the District Court adjudicating the consolidated appeals, or (iii) the date of entry of an order by the District Court adjudicating any motion brought by the Landlord to extend the existing stay." (D.I. 50 at 1-2 (quoting the Bankruptcy Court's 4/29/04 Supplemental Stay Order).) The practical effect of the Bankruptcy Court's Supplemental Stay Order is that the stay expires upon issuance of this Memorandum Order. Therefore, in its Motion, the Landlord "seeks a stay [of distribution] until the issuance of the mandate following a final disposition by the U.S. Court of Appeals for the Third Circuit of any appeal[,]" or in the alternative, asks "that the stay of distribution be extended until 10 days after this Court's order adjudicating these consolidated appeals, so as to allow either party an opportunity to seek a stay in the Court of Appeals." (D.I. 50 at 2.)

When considering whether to issue a stay in this context, the following factors must be considered: (1) the likelihood of success on the merits of the appeal; (2) the likelihood that the appellant will suffer irreparable harm if the stay is not granted; (3) the absence of substantial harm to other interested parties; and (4) the injury, if any, to the public interest. *See Republic of Phillippines v. Westinghouse Elec. Corp.*, 949 F.2d 653, 658 (3d Cir.1991); *In re Delaware & Hudson River Co.*, 90 B.R. 90, 91 (Bankr.D.Del.1988). "[T]hese four factors structure the inquiry. However, no one aspect will necessarily determine its outcome. Rather proper judgment entails a delicate balancing of all the elements." *In re Roth American, Inc.*, 90 B.R. 94, 95 (Bankr.M.D.Pa.1988) (citations and internal quotation marks omitted).

The Landlord argues that, in this case, the balance of hardships weighs in favor of granting a stay. (D.I. 50 at 6-7 (citing *In re Hoekstra,* 268 B.R. 904, 906 (Bankr.E.D.Va.2000) (where questions going to the merits are sufficiently substantial or difficult "as to make them fair ground for litigation" the "primary weight should be given to the balance of the hardships" (internal quotations omitted)).) In response, the Debtor argues that, because the Bankruptcy Court and this court have expressed the view that the Landlord is not likely to succeed on appeal, I need not conduct an inquiry into the balance of hardships.[15] (D.I. 52 at 10 (case citations omitted).)

I too am skeptical of the Landlord's prospects for success on appeal, but that alone is not enough to deny the Landlord's Motion. As the Bankruptcy Court previously noted, the Landlord is likely to suffer irreparable harm if a stay is not granted; otherwise, if the Landlord prevails on appeal and "there is no stay, it's likely that that will be a pyrrhic victory." (4/29/03 Tr. at 49:19- 20.) There is also little harm to the Debtor in continuing the stay, particularly in light of the fact that the Landlord has posted a $2.5 million bond pending

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15. During the hearing regarding the Landlord's initial Motion to Stay, the Bankruptcy Court stated, "I haven't heard anything new today. And I don't think the matter's going to be reversed on the merits." (4/29/03 Tr. at 49:15-16.) In a May 30, 2003 Order denying the Landlord's Emergency Motion to modify a prior stay Order of the Bankruptcy Court, the Honorable Joseph J. Farnan, Jr. said, "Due to recent case law in this Circuit [*PPI Enters.*] which is against the Landlord's arguments, the Court concludes that the Landlord has little likelihood of success on appeal." (D.I. 52, Ex. B at 3.)

appeal.[16] For these reasons, the Landlord's Motion will be granted to this extent: the stay of distribution will be extended until 10 days after the date of this Memorandum Order.

V. CONCLUSION

I find that the Bankruptcy Court, by conducting a fact-intensive inquiry and balancing that totality of the circumstances of this case, exercised sound discretion when it reached its decision that the Debtor's Chapter 11 filing satisfied the good faith requirement. See *PPI Enters.*, 324 F.3d at 211-12. Because the Bankruptcy Court's conclusions do not constitute an abuse of discretion, it is hereby ORDERED that the Bankruptcy Court's January 30, 2003 Order denying the Landlord's Motion to Dismiss and its April 16, 2003 Order confirming the Debtor's Second Amended Plan of Liquidation under Chapter 11 are AFFIRMED. It is further ORDERED that the Landlord's Motion to Extend the Stay of the Confirmation Order Pending Appeal (D.I.50) is GRANTED in that the stay is extended until 10 days after the date of this Memorandum Order.

s Kent A. Jordan
UNITED STATES DISTRICT JUDGE

Wilmington, Delaware
May 19, 2004

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16. The Debtor argues that, if the Landlord's Motion is granted, its shareholders will continue to lose the opportunity to reinvest the $23 million that otherwise would have been available for distribution under the plan, thus denying them the opportunity realize a gain on their investments. (D.I. 52 at 11.) This speculative argument is not enough to tip the balance of hardships in favor of the Debtor.

APPENDIX C — EXCERPT OF TRANSCRIPT OF OMNIBUS HEARING DATED JANUARY 8, 2003

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

Case No. 02-12945

Courtroom No. 2
824 Market Street
Wilmington, Delaware 19801

January 8, 2003
1:33 P.M.

IN RE: INTEGRATED TELECOM EXPRESS,

Debtor.

TRANSCRIPT OF OMNIBUS HEARING
BEFORE HONORABLE PETER J. WALSH
UNITED STATES CHIEF BANKRUPTCY JUDGE

* * *

THE COURT: . . .

I'm going to deny the motion to dismiss on the grounds of a bad faith filing because as the case law clearly indicates, not limited to my case, PPI[1] case, the solvency of the debtor and the fact that the equity interest holders will receive a

1. *Solow v. PPI Enters. (U.S.) (In Re PPI Enters. (U.S.))*, 228 B.R. 339, (Bankr. D. Del. 1998), *aff'd* 324 F.3d 197 (3d Cir. 2003).

distribution does not serve as the basis for a finding of bad faith, and I'll discuss the case law in a little bit more detail.

But I want to start first with the testimony of Mr. Granum, which I found interesting in that here is a person very sophisticated in the real estate market, suggesting that he was sucked into a transaction that -- he didn't say anybody misrepresented anything. In fact, he specifically testified that there were no misrepresentations by Mr. Gardner. But his [124] suggestion is that he got sucked into this transaction for a lot of reasons that should not now result in his being subject to the Section 502 (b)(6) cap.

But I find that testimony really difficult to accept, to put it bluntly. The -- Mr. Granum testified that he looked at the IPO prospectus, document number 13, and it looks like a lot of others that I've seen, including -- if I could quickly point out -- a ten-page small print detailed discussion of the risk factors. And I realize that these prospectuses have to put these in. But I find it difficult -- it's obviously easy to say in retrospect that a big mistake was made by a lot of people, including the IPO purchasers, but you can't ignore the detailing of the risk factors and simply say that, as a landlord, everything is going to be fine and rosy, they have a lot of cash and there's nothing to worry about. I just can't accept that in the light of what the prospectus tries to tell intelligent investors, and it certainly seems to me that Mr. Granum is an intelligent individual.

And, quite frankly, I'm struck by the September 18, 2000 letter, that's document number 25. And the witness testified about his calculation of the $60,000 a month. But I just want

to quote from that letter. It says, "Yes, I have a lot of options, but I am paying at least $60,000 a month for the privilege and opportunity to," quote, "ride with the bulls," closed quote, "they are great people and I can only [125] hope my instincts are accurate in this wild technology era which we are privileged to be a part of. It is like the modern day renaissance. Silicon Valley is, indeed, Florence!" exclamation point.

I must say that Mr. Granum elected to ride with the bulls. And I think he's likely to get gored by the consequences of this case. My point is that he is a sophisticated individual. He took the risk. He hoped his instincts were right. They were wrong. And he must suffer the consequences.

This particular case is perhaps one of at least a dozen, perhaps 20 of telecom cases that I have where parties in interest have taken dramatic, to say the least, losses. And so I think that this landlord is really in not much different position than a lot of other landlords and a lot of creditors and a lot of investors who have suffered the consequence of the telecom debacle. They all made mistakes.

Let me go back to some of the testimony offered by the debtor. There were offered a number of reasons for the filing of the bankruptcy case. While I believe there is validity to a number of those considerations, I do not rest my conclusion on the fact that all of those elements suggest the advisability, of proceeding in a Chapter 11 case rather than the Chancery Court.

But even assuming that those other factors are not [126] particularly persuasive, even assuming or accepting the landlord's position, particularly illustrated by the Board of Directors' minutes of August 13 of 2002, that the principal reason for the Chapter 11 case was to cap the damage claim for the landlord, I conclude that as a matter of law, that is not a debilitating fact. I held in the *PPI*,[2] and other cases have held, that it does not establish bad faith for a debtor to file a chapter case for the purpose of taking advantage of provisions which alter pre-petition rights, including altering the rights of a landlord under State law.

I want to focus on the benefit to the shareholders of this bankruptcy. It's true that there will be a significant distribution to the shareholders. But if one looks at the history of this case, you easily conclude that the shareholders are not coming out whole by any means, that is as a group, as opposed to some insiders. And I think some of the testimony supports some of the observations I made when I reviewed the documents. In the August 17, 2000 IPO, there were 5.6 million shares offered at $18 a share. So, we have people who put in over $100 million into this company at that time and some of those people, presumably, are now -- are going to get a distribution of maybe -- what is it, a $1.80 a share. Obviously you can't consider that they are being treated any windfall.

After the IPO was effected, the stock was trading in [127] the range of 25 to $30 a share. And if you simply -- if you capitalize that to the 41 million outstanding shares, you come up with a large number. For example, if you simply multiplied

2. *In Re PPI Enters. (U.S.)*, 228 B.R. at 339.

that 41 million by $18, you get a 'capitalization of $700 million -- I got $43 million [sic]. And I think one of the witnesses testified to this effect and to the effect that at today's trading prices, that's $65 million. So, somebody -- certainly in the aggregate, shareholders are taking a hit in this case.

What I think is also significant in this case is that the capitalization of the company, in my review of the documents, I concluded that at the time of the IPO, and at fiscal year end December 31, 2001, and at June 30, 2002, this debtor had no significant debt. And that, quite frankly, is unusual in terms of the telecom cases that I have presided over where debt holders have taken very, very large hits on their investment.

The difference in this case is that the company was not at all leveraged. And if the distribution were, for the most part, or totally to go to the creditors, there would be no basis for the landlord to complain regarding some equitable principle.

But don't think the Code makes any distinction. And I think that the -- why this case is different is because the debtor simply was not leveraged. And instead of the significant distribution going to debt holders if the plan is confirmed and the matter is concluded, it's going to go to the [128] shareholders.

Next, I want to comment regarding the argument made by the landlord about who the shareholders are to be treated under this plan. And I'm focusing on the argument made at Page 9 of the landlord's pretrial brief, and that's Document

Number 146. To the effect that, quote, "Most current shareholders," close quote, will not lose any money in the liquidation. I think this argument is logically flawed. The argument incorrectly assumes that the shares traded during the subject periods had not been previously traded during those periods. And this argument simply cannot be made on the basis of just adding up the number of transactions made during the period.

Also, I would ask what about the shareholders who bought in at $18 in the IPO or when it went up to $25 or when it went up to $30, haven't they been injured? Isn't their distribution as current shareholders, and we don't know to what extent they are current shareholders, and I don't think anybody can demonstrate to what extent those current shareholders are shareholders who bought in high or low or whatever. I don't think the information can furnish that answer. But the argument that the landlord puts forth, I think, is faulty in that regard.

And to me, this situation is no different than the situation where creditors sell their claims at deep discounts from face value. Such creditors have already suffered. Even [129] if at plan distribution time, their transferees do not. Claims trade on the basis of expected recovery. And I suspect that the interest, i.e., the stock is trading on the basis of expected recoveries. And the losses that have -- the losses to the shareholders, to a very, very significant degree, have already been sustained.

And in that regard, aside from the IPO $18 a share of people who were obviously severely injured by this company,

I think the testimony is -- and I'm looking for it -- I think it was Mr. Williams' testimony, that the total paid in capital was $220 million. So, even by that simple calculation where you take into account the cheap shares that the insiders bought early on in the case, you still have the shareholders taking a significant hit in any distribution under a Chapter 11.

Let me just see if there was anything else that I wanted to comment on in the testimony, and then I want to turn to the case law.

(Pause)

THE COURT: With respect to the case law, I think I've said just about everything I wanted to say on this issue in the *PPI*[3] case. But I think it is significant that there are three other decisions that agree with that proposition, namely that a solvent debtor can avail itself of the 502(b)(6) cap. The other cases, of course, are the *Federated*[4] decision and the *Farley*'s[5] decision. And these are discussed in the debtor's [130] memorandum.

And finally we have the very recent decision by the 9th Circuit, the *Sylmar Plaza*[6] decision, which I found significant

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3. *In Re PPI Enters. (U.S.)*, 228 B.R. at 339.

4. *In Re Federated Dep't Stores, Inc.*, 131 B.R. 808 (S.D. Ohio 1991).

5. *In Re Farley*, 146 B.R. 739 (N.D. Ill. 1992).

6. *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In Re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002).

in that it was only decided about a week ago. And this case is almost on all fours with the situation before me. I'm sure the parties are familiar with the holding where the court found that the cure provision of the Code allowed a solvent debtor to deny a default interest rate to a secured lender. And that was not a bad faith plan provision.

I want to comment upon a couple points made by the court in that case. The first point I would note is -- and this is Page -- on Page 3 of the printout from the Westlaw citation. The Court says the Hornwoods, and that's the debtor, "The Hornwoods' further argument that the appeal is barred by res judicata because the Bankruptcy Court denied Platinum's motion to dismiss is without merit. There can be no bar in the absence of a final judgment."

And the point is that it's clear that this case was directed at a bad faith plan, but it's clear that the Bankruptcy Court likewise denied the creditor's motion to dismiss on the same grounds.

Then in discussing the law on that same page, the Court says, "Platinum contends" -- let me just back-up. First of all, on that same page, the Court says, "The argument that Platinum makes is as follows. Platinum puts it this way. The [131] plan was crafted solely to permit the debtors to take advantage of the Bankruptcy Code to profit personally at the expense of a creditor," closed quote. That is the sum and substance of the landlord's argument in this case. And, of course, that was rejected by the Bankruptcy Court. It was rejected by the BAP. And it was rejected by the Court of Appeals.

Appendix C

Continuing on on Page 3 of the reported opinion, it says, "It says Platinum contends that a plan lacks good faith when it does not serve the purposes of the Bankruptcy Code. Here it argues the plan leaves the Hornwoods solvent while permitting them to avoid paying post petition interest at the default rate. However, insolvency is not a prerequisite to a finding of good faith under Section 1129(a)."

And then the Court goes on and quotes from the *PPI*[7] case. And the Court further goes on and says, "Platinum cites a number of cases in an effort to support its proposed per se rule." And the Court then cites those cases, including the citation to the 3rd Circuit decision in *SGL Carbon*.[8] And then the Court goes on and says, "None of those cases adopts or approves a per se rule." And on that point, I would simply say for the same reason I find that the *SGL Carbon* decision does not require me to revisit my views expressed in the *PPI* case.

The next quote I would make from that case is on Page 4 and the court says, quote, "Given the specific power to cure [132] default, it makes no sense to treat a plan invoking that power as lacking good faith," closed quote. I think that observation is equally applicable to Section 502(b)(6).

So, in looking at the *Sylmar* case, I conclude that the Court reached the same result for the same reasons as I did in the *PPI* decision.

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7. *In Re PPI Enters. (U.S.)*, 228 B.R. at 344-45.

8. *In Re SGL Carbon Corp.*, 200 F.3d 154 (3d Cir. 1999).

And with respect to the request to transfer of venue, in my view, if the case were sent to California, the result would be the same by reason of the Court of Appeals' decision in *Sylmar Plaza.*

Let me make one other comment. The landlord makes a big to-do about the fact that the debtor first embarked upon a State law control liquidation and then came up with the idea to go into Chapter 11 proceeding in order to take advantage of Section 502(b)(6). And I would pose this question: How is this case before us where a debtor deliberately abandons a State law controlled liquidation in favor of a Bankruptcy Code liquidation, how is that different from the situation where a debtor, on advice of counsel, pursues no liquidation scenario other than a Bankruptcy Code one? And I submit that the answer is there can be no difference.

If debtors are entitled to take advantage of the provisions of the Bankruptcy Code, it doesn't make any difference to make -- it doesn't seem to make any difference that at a time they entertained a different approach of not [133] taking advantage of the Bankruptcy Code. And so, we now have, in addition to the *PPI* case, three opinions which say that the landlord's theory for having this case dismissed doesn't hold up under the scrutiny of the Bankruptcy Code. And for those reasons, I'm going to deny its motion.

And let me just review my notes to make sure I haven't missed anything.

Appendix C

Another observation I should make. The testimony of Mr. Regel was that when he was brought into the company in September of '01, the company was experiencing a dramatic downward spiral. They hired Booze-Allen, they hired Lehman Brothers to see what salvation or alternative there might be. And concluded that they had two possibilities. Either liquidate or pursue a different business plan than that which they told their investors they were embarked upon when they had the IPO.

And Mr. Regel testified that he felt that the Board exercised its fiduciary responsibility in pursuing a liquidation course of action. And I think they were absolutely right. Because in my view, faced with that situation where investors put money in with a specific business plan, I don't think the Board can discharge its financial -- discharge its fiduciary duty by exercising its own judgment to embark upon a different business plan, *i.e.* do something that the investors didn't intend that they do. And I think the Board had an [134] obligation, and appropriately exercised that obligation, to give the investors their money back.

I think that covers the points I need to cover to make my ruling.

And with respect to the motion to transfer venue, two observations: I've already made the observation that you go to California, I think you have the same case law now by a Court of Appeals, not just a Bankruptcy Court.

Secondly, I suppose that the landlord will entertain the notion of taking an appeal from this decision. And I think it

would be inappropriate to transfer the case out to California and pursue the appeal process there. I think that in all fairness, the parties should be able to pursue this matter as far up as they wish through the initial channels that brought them here.

In addition to those factors -- those two factors, the fact of the matter is this debtor is not in business any longer. This case is -- as a liquidating case, is on the tail end of its existence. The plan is about to be filed. The disclosure statement hearing is coming up. And I think it would be unfair to impose upon a new bankruptcy judge all of the history that we have experienced here and the matters that we have observed, and ruled upon to take the case in that fashion, the analogy of changing horses in the middle of the stream I think is appropriate in this case.

[135] Quite frankly, had the venue issue come up within the first 30 days of the case, I may very well have looked at it differently. But I think we've really reached the point where there's nothing going on in this case in terms of business. It's a wind up. And I just don't see that there's much activity required of anybody here who may now be in California. I think there may be a lot of lawyering, but my view is that lawyers can go anyplace. That is they can go to any forum.

Okay. I think that pretty much sums up the basis for my ruling.

MR. LEWIS: Your Honor, if I might just make one brief comment. I don't want to argue the matter, I understand the Court's ruling. But I would like to make it clear that our position on the bad faith issue is not that solvency, per se, is

a bar. Our position is that to invoke bankruptcy you have to have some pending or actual financial distress, even if you are solvent. If you look at the cases, all the cases --

THE COURT: That's not what the *Sylmar* case says.

MR. LEWIS: Well, in *Sylmar*, Your Honor, the debtor couldn't pay its mortgage. That's why it filed a bankruptcy.

THE COURT: Well, this debtor was losing a lot of money.

MR. LEWIS: It was facing foreclosure.

THE COURT: Well, this debtor was losing a lot of money and it had an obligation to its creditors and its [136] investors.

MR. LEWIS: Your Honor, I understand the Court's position. I just think that -- I want to be sure that our position is accurately characterized.

THE COURT: Okay.

MR. LEWIS: And that's what it is. Thank you.

MR. KELLER: Your Honor, we will --

THE COURT: Let me just comment on that. In the *Sylmar* case, I already quoted from the Court where it said the complaint of the creditor was that the debtors were trying to take advantage of the Bankruptcy Code, quote, "to profit personally at the expense of a creditor."

Isn't that what this case is about? Isn't that what your argument is about?

MR. LEWIS: Your Honor, in *Sylmar*, they had already filed what I would have considered a legitimate bankruptcy, namely that they were facing foreclosure and they entered bankruptcy in order to try to find a way to reorganize. And in the course of that, they were able to use a section that permits them to cure default interest or to reverse out default interest. This is a different case. There was no financial distress there's only money coming into this case.

THE COURT: You don't call the company's financial affairs distressful?

MR. LEWIS: I call the company's financial affairs [137] having a lot of money and relatively little debt. And a decision to go out of business before it got to be a crisis.

THE COURT: And an obligation to its creditors and shareholders.

MR. LEWIS: Well, Your Honor, I guess we just see the law differently here. I understand the Court's position, but I think this is a very different case than *Sylmar*.

THE COURT: Okay.

MR. LEWIS: Thank you.

MR. KELLER: Your Honor, just as a matter of housekeeping, I believe --

THE COURT: Pardon?

MR. KELLER: As a matter of housekeeping, we will submit then, I believe, three orders. One is, I believe, now the rejection can come effective of the lease. Secondly we've got the motion on to change the venue and the motion to dismiss, we'll run drafts by the landlord's counsel and submit those separately.

THE COURT: Okay.

MR. KELLER: Thank you.

THE COURT: Anything else?

MR. LEWIS: No, Your Honor. Thank you.

THE COURT: Okay. We stand in recess.

(CONCLUSION 5:08 P.M.)

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING DATED NOVEMBER 23, 2004

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case No.: 04-2411

IN RE: INTEGRATED TELECOM EXPRESS, INC. a/k/a INTEGRATED TECHNOLOGY EXPRESS, INC. a/k/a DELAWARE INTEGRATED TELECOM EXPRESS, INC.,

Debtor

NMSBPCSLDHB, L.P.,

Appellant

v.

INTEGRATED TELECOM EXPRESS, INC.; AND THE OFFICIAL COMMITTEE OF EQUITY HOLDERS, et al.

SUR PETITION FOR REHEARING

Present: SCIRICA, *Chief Judge*, SLOVITER, NYGAARD, ALITO, ROTH, MCKEE, RENDELL, BARRY, AMBRO, FUENTES, SMITH, CHERTOFF, FISHER, VAN ANTWERPEN, BECKER and GREENBERG, *Circuit Judges.**

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* The votes of the Honorable Edward R. Becker and the Honorable Morton I. Greenberg, Senior United States Circuit Judges for the Third Circuit, are limited to panel rehearing.

Appendix D

The petitions for rehearing filed by appellees in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petitions for rehearing by the panel and the Court en banc, are denied. Judge Rendell and Judge Ambro would grant the petitions for rehearing.

BY THE COURT,

/s/ D. Brooks Smith
Circuit Judge

Dated: November 23, 2004

Appendix D

AMBRO, Circuit Judge, Dissenting to the Denial of Rehearing Banc, joined by Judge Rendell:

We voted for rehearing *en banc* not because we believe that the panel has necessarily reached the wrong result. The core effect, as we perceive it, of the panel's holding—that equity holders of a debtor may not file a chapter 11 bankruptcy petition solely "to reap [for themselves] a substantial gain through bankruptcy ... at the expense of the [debtor's] sole creditor," Op. n.4—may pass muster with the unique facts this case presents. Our problem is this: counsel in other cases may argue the panel's opinion to go further in requiring good faith than anyone on the panel intended. We thus voted for rehearing *en banc* to allow the full Court to dispel this argument, for we believe the panel's opinion is limited to its snow in August facts.

APPENDIX E — ORDER DENYING NMSBPCSLDHB, L.P.'S MOTION TO DISMISS CHAPTER 11 CASE OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE DATED JANUARY 30, 2003

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Chapter 11

Case No. 02-12945 (PJW)

Related to Docket No. 58

In re:

INTEGRATED TELECOM EXPRESS, INC.,

Debtor.

ORDER DENYING NMSBPCSLDHB, L.P.'S MOTION TO DISMISS CHAPTER 11 CASE

Upon consideration of the motion of NMSBPCSLDHB, L.P. to dismiss the above-captioned chapter 11 case (the "Motion to Dismiss"); and upon consideration of all papers and pleadings submitted in connection therewith, including any briefs, responses and replies; and upon consideration of the testimony, evidence, and any arguments presented at the hearing on January 8, 2003 (the "Hearing"); and upon consideration of the record established at the Hearing and the record of the case; and it appearing that this

Appendix E

Court has jurisdiction over the Motion to Dismiss pursuant to 28 U.S.C. §§ 157 and 1334; and it appearing that this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O); and after due deliberation and sufficient cause appearing therefor,

IT IS HEREBY ORDERED THAT:

1. The Motion to Dismiss is denied for the reasons stated on the record at the Hearing.

2. This Court retains jurisdiction with respect to all matters arising from or related to the implementation of thus Order.

Dated: Jan. 30, 2003

s/ Peter J. Walsh
The Honorable Peter J. Walsh
Chief United States Bankruptcy Judge

APPENDIX F — RELEVANT STATUTE

§ 109. Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not—

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association,

building and loan association, homestead association, or credit union, engaged in such business in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $ 307,675 and noncontingent, liquidated, secured debts of less than $ 922,975 or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $ 307,675 and noncontingent, liquidated, secured debts of less than $ 922,975 may be a debtor under chapter 13 of this title.

(f) Only a family farmer with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—

Appendix F

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(2)

Supreme Court, U.S.
FILED
MAY 6 - 2005
OFFICE OF THE CLERK

No. 04-1179

IN THE

Supreme Court of the United States

INTEGRATED TELECOM EXPRESS, INC. AND THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS,

Petitioners,

v.

NMSBPCSLDHB, L.P.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals properly concluded, after conducting a "fact intensive inquiry," that a debtor failed to meet its burden of establishing that a Chapter 11 petition was filed in good faith when the debtor was financially healthy, with no intention of reorganizing or liquidating; with no reasonable expectation that Chapter 11 proceedings would maximize the value of the debtor's estate; and solely to take advantage of a provision in the Bankruptcy Code that limits claims on long-term leases.

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IN THE

Supreme Court of the United States

No. 04-1179

INTEGRATED TELECOM EXPRESS, INC. AND THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS,
Petitioners,

v.

NMSBPCSLDHB, L.P.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

Petitioner Integrated Telecom Express, Inc. (the "Debtor") filed for bankruptcy protection under Chapter 11 despite holding over $100 million in cash and having no significant debts other than the $26 million it owed to the Respondent, NMSBPCSLDHB, L.P. (the "Landlord"), for damages relating to the termination of a lease. The Debtor filed its bankruptcy petition not in order to accomplish any legitimate bankruptcy purpose, such as to reorganize, to liquidate, or to maximize value for the benefit of its creditors. Rather, as indicated by the Debtor's own Board minutes—which the Court of Appeals described as a "smoking gun"—the Debtor filed for bankruptcy for the sole purpose of frustrating the Landlord's claim, by seeking to take advantage of a provision of the Bankruptcy Code that caps a landlord's damages claim. On these extreme facts, the Court of Appeals properly concluded that the filing served no legitimate

bankruptcy purpose, and therefore directed that the bankruptcy case be dismissed. Accordingly, the case involves a straightforward—and manifestly correct—application of the "good faith" doctrine to the peculiar facts of this case. There is no division of authority in the lower courts and no issue warranting this Court's review is presented. The petition should be denied.

STATEMENT OF THE CASE

1. The Debtor's business model was to supply equipment to the broadband communications industry, and it raised approximately $110 million in cash in August 2000 in an initial public offering. Pet. App. 46a. In the same time period, the Debtor negotiated a lease of real property at 400 Race Street, San Jose, California, with Granum Holdings, predecessor in interest to the Landlord, NMSBPCSLDHB, L.P. *Id.* at 47a. Thereafter, the market for communications equipment collapsed, and the Debtor decided to dissolve under state law. At the time, the Debtor had approximately $117 million in cash, and its only significant debt was the lease it had signed with Respondent. On April 18, 2002, the Debtor's Board of Directors approved a Plan of Complete Liquidation and Dissolution under Delaware law. *Id.* at 48a.

Having pursued state-law dissolution for nearly four months, the Debtor's Board of Directors abruptly changed its course after an August 13, 2002, meeting with bankruptcy counsel. Pet. App. 48a. The Board minutes reflect that the meeting was called for the sole purpose of discussing whether to file bankruptcy to cap the Landlord's claim under § 502(b)(6) of the Bankruptcy Code. The minutes state that "the landlord did not appear to believe that the Company would seriously consider making a bankruptcy filing." *Id.* at 5a. They continue:

> After additional discussion, the Board approved the following resolutions:
>
> RESOLVED: That the officers of the Company are, and each of them hereby is, authorized and directed to send the landlord the letter prepared by

> Murray and Murray in substantially the form reviewed with the Board.
>
> RESOLVED FURTHER: That the officers of the Company are, and each of them hereby is, authorized and directed to negotiate a settlement with the landlord up to a maximum settlement amount of $7 million.
>
> RESOLVED FURTHER: That the Board hereby appoints [Peter Courture and David Lam, and each of them, to] a special committee (the "Committee") that is hereby empowered on behalf of the Board to authorize the officers of the Company to enter into a settlement with the landlord up to a maximum settlement amount of $8 million.
>
> RESOLVED FURTHER: That the officers of the Company shall be required to seek approval from the Board prior to entering into an [sic] settlement with the landlord in excess of $8 million.
>
> ....
>
> RESOLVED FURTHER: *That if the landlord is not willing to enter into a settlement agreement with a maximum amount of $8 million, then the officers of the Company shall be, and each of them hereby is, authorized and empowered on behalf of, and in the name of, the Company to execute and verify or certify a petition under Chapter 11 of the Bankruptcy Code* and to cause the same to be filed in the appropriate United States Bankruptcy Court (the "Bankruptcy Court") at such time as said authorized officer executing the same shall determine.

Pet. App. 6a-7a. (emphasis added). The minutes thus set up a simple if-then clause: "*if* the landlord is not willing to enter into a settlement agreement with a maximum amount of $8 million, *then* the officers of the Company shall be ... authorized and empowered on behalf of ... the Company to execute and verify or certify a petition under Chapter 11 of the Bankruptcy Code." *Id.* at 7a. (emphasis added). The minutes discuss no other reason for the filing.

Two days later, on August 15, 2002, the Debtor's bankruptcy counsel sent a letter to the Landlord threatening to file for bankruptcy if the Landlord did not agree to greatly reduce its claim. Pet. App. 7a-8a. The letter said that the Landlord's claim would be subject to the § 502(b)(6) cap in bankruptcy and indicated that if the Landlord refused to settle, the Debtor would file for bankruptcy, which would result in a reduction in the Landlord's claim. *Id.* at 8a-9a.

The Landlord did not agree to settle. On October 8, 2002, the company filed for bankruptcy under Chapter 11. At the time it filed its petition, the Debtor had $105.4 million *in cash* and other assets worth approximately $1.5 million. Pet. App. 9a. The present discounted value of the remaining lease obligations to the Landlord, which represented the Debtor's only significant indebtedness, was approximately $26 million. The Debtor's other liabilities came to approximately $430,000. *Id.* [1]

2. The Landlord moved to dismiss the bankruptcy case on October 28, 2002, arguing that the Debtor had filed its petition in bad faith, in violation of 11 U.S.C. § 1112(b). Pet. App. 10a. The bankruptcy court held an evidentiary hearing on the motion on January 8, 2003. At the hearing, the Debtor contended that its effort to threaten the Landlord, which was detailed in the Board minutes, was not actually the only reason it sought to file for bankruptcy. The bankruptcy court expressly declined to consider whether the Debtor's post hoc justifications provided a good faith basis for proceeding in bankruptcy; instead, the bankruptcy court

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[1] The Debtor's only other potential liability related to a securities class-action lawsuit in which the Debtor has been named as a defendant. The Debtor has represented to the SEC and its shareholders that this lawsuit is without merit:

> The company believes that the claims against it are without merit and intends to defend this lawsuit vigorously. While the outcome of these claims is currently not determinable, the Company does not expect that the ultimate costs to resolve these claims will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Pet. App. 31a.

went on to hold as a matter of law that the filing of a Chapter 11 petition for the sole purpose of capping a Landlord's claim did not constitute bad faith. *Id.* at 10a, 64a. On April 7, 2003, the bankruptcy court held a confirmation hearing. The order confirming the plan was entered on April 16, 2003. *Id.* at 13a.

3. The Landlord appealed to the United States District Court for the District of Delaware, which affirmed the Bankruptcy Court's order on May 19, 2004. Pet. App. 43a-60a. In doing so, the District Court expressly declined to engage in a *de novo* review of the Bankruptcy Court's legal conclusion, instead applying an abuse-of-discretion standard. *Id.* at 53a-54a & n.11.

4. The Court of Appeals for the Third Circuit reversed. Pet. App. 1a-42a. As it explained, "[t]he failure of Integrated's business did not subject the company to any pressure on the value of its assets that could be reduced or avoided in an orderly liquidation under Chapter 11." *Id.* at 30a. Pointing out that "a petition must do more than merely invoke some distributional mechanism" (*id.* at 41a), the Court of Appeals concluded that Debtor had not demonstrated an intent to reorganize or liquidate.

The Court of Appeals then examined the question of whether Debtor had satisfied its good faith obligation simply by attempting to take advantage of the § 502(b)(6) landlord cap. Recognizing the board resolution that authorized the letter threatening the Landlord as a "smoking gun" (Pet. App. 41a), the Court of Appeals concluded that the Debtor was using § 502(b)(6) not for any legitimate bankruptcy purpose, but rather as a litigation tactic. Therefore, based on its conclusions "on the facts of this case" (*id.* at 3a), that Petitioner had no legitimate bankruptcy purpose for filing under Chapter 11, and in fact that it filed solely as a litigation tactic, the court held that Integrated had not met its burden of demonstrating good faith, and that its bankruptcy petition should be dismissed.

Petitioner filed a petition for panel rehearing and rehearing en banc. The Court of Appeals denied the petitions.

Pet. App. 76a-77a. Dissenting from the denial of rehearing en banc, Judges Ambro and Rendell stated that they would hear the case en banc "not because we believe that the panel has necessarily reached the wrong result," on the "unique facts this case presents," but rather because some of the opinion's language may be misconstrued to extend the good faith requirement further than the panel intended—which the dissenters believed was limited to this case's "snow in August facts." *Id.* at 78a.

ARGUMENT

This case involves an extraordinary—and extraordinarily unusual—set of facts. The Debtor was not only solvent, but suffering no financial distress; it could easily have satisfied all the claims against it in full. The Debtor filed with no intention of either reorganizing or liquidating as a going concern—indeed, when the Debtor filed for bankruptcy it was little more than a pile of cash to be distributed to creditors and shareholders. And the Debtor filed for bankruptcy solely in order to cap the Landlord's claim against it and thereby enrich the Debtors' equityholders. *See* Pet. App. 2a-3a.

Under these circumstances, the Court of Appeals' determination that the Debtors' filing was not in good faith is nothing more than a routine, factbound—and clearly correct—application of the good-faith doctrine. Indeed, even the two Third Circuit judges who dissented from the denial of rehearing en banc agreed that the panel had reached the correct result on these "snow in August facts." Pet. App. 78a. Because no circuit split exists, the case represents the application of a well-settled doctrine to an extreme set of facts, and the decision below was correct on the merits, this case does not warrant this Court's review.

I. THERE IS NO DIVISION OF AUTHORITY WITHIN THE COURTS OF APPEALS

Petitioner argues that *Platinum Capital, Inc.* v. *Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002) is "analytically indistinguishable" from this

case, and thus that the Third Circuit's decision creates a circuit split with the Ninth Circuit. Pet. 14. This argument misrepresents the facts and holding of *Sylmar Plaza*, which is readily distinguishable from this case.

It is well-settled—and both the Third Circuit below and the Ninth Circuit's decision in *Sylmar Plaza* held—that a bankruptcy petition is in good faith only if, on the particular facts of the case, there was a proper bankruptcy purpose for the filing. *See* Pet. App. 18a-20a; *Sylmar Plaza*, 314 F.3d at 1074 (good faith inquiry turns on whether the action "achieves a result consistent with the objectives and purposes of the Code"). "Whether the good faith requirement has been satisfied is a 'fact intensive inquiry' in which the court must examine 'the totality of facts and circumstances' and determine where a 'petition falls along the spectrum ranging from the clearly acceptable to the patently abusive.'" Pet. App. 17a-18a (quoting *In re SGL Carbon Corp.*, 200 F.3d 154, 162 (3d Cir. 1999)); *accord Sylmar Plaza*, 314 F.3d at 1074 ("The . . . good faith determination is based on the totality of the circumstances.").

Thus, both the Third Circuit below and the Ninth Circuit in *Sylmar Plaza* applied the same test for good faith, in light of the "totality of the circumstances" in each case. And the outcome of the two cases differed *not* because the two circuits applied different legal standards, but simply because the "totality of the circumstances" in the two cases mandated different results.

Two critical features of *Sylmar Plaza* distinguish it from this case: the debtor (although technically solvent) was in financial distress; and it sought to liquidate assets in Chapter 11 so as to maximize the value to the estate. As the Third Circuit explained, the holding in *Sylmar Plaza* "cannot be divorced from the facts of that case, which reveal that the Bankruptcy Code was used to maximize value for creditors as a whole." Pet. App. 29a; *see also id.* at 27a (noting that "[t]he absence of any financial distress facing [the Debtor] distinguishes" *Sylmar Plaza* from this case). Specifically, in *Sylmar Plaza* the debtors owned a shopping center that was subject to a secured bank loan. The debtors

"encountered cash flow problems" and defaulted on the loan. *Sylmar Plaza*, 314 F.3d at 1072-1073. By filing for bankruptcy, the debtors were able to sell the shopping center free and clear of the bank lien, thereby realizing a higher value than would have been possible outside of bankruptcy.[2] *Id.* at 1073.

Based on the totality of the circumstances, the Ninth Circuit held that the debtor's filing in *Sylmar Plaza* had a proper bankruptcy purpose, rejecting the creditor's argument that a petition filed in order to take advantage of a particular beneficial provision of the Bankruptcy Code was *per se* in bad faith. *See* 314 F.3d at 1075.

The proper bankruptcy purpose present in *Sylmar Plaza* is utterly lacking in the present case. The Debtor here was in no financial distress of the sort experienced by the debtor in *Sylmar Plaza*; indeed, it "was highly solvent and cash rich at the time of the bankruptcy filing." Pet. App. 29a. And, because the Debtor was merely a pile of cash at the time of the bankruptcy filing, the filing did nothing to maximize value for the estate. *Id.* at 30a. Rather, the sole purpose of the filing was to cap the Landlord's claim for the benefit of Debtor's equityholders.

Petitioners gloss over this essential distinction and focus instead on the idea that the debtor in both cases sought to take advantage of a Code provision. Petitioners thus contend that *Sylmar Plaza*'s statement that filing in order to take advantage of a provision of the Bankruptcy Code is not *per se* in *bad* faith conflicts with the Third Circuit's statement that filing in order to take advantage of a Bankruptcy Code provision is not *per se* in *good* faith. Pet. 17 & n.9. But merely stating this supposed conflict demonstrates that

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[2] Petitioners contend that the sale in *Sylmar Plaza* generated value only for equity holders and not for creditors. Pet. 16. The point, however, is that the sale of the shopping center free and clear of the lien generated value for the estate that could not have been realized outside of bankruptcy—and maximizing value for the estate of a financially distressed debtor is a bankruptcy-related purpose not present in this case, where the financially healthy Debtor's assets consisted of cash that passed through the bankruptcy unchanged in value.

there is no conflict at all: because *every* debtor files with the desire to take advantage of a Bankruptcy Code provision, that desire cannot by itself establish either bad faith or good faith. Rather, as both the Third Circuit and the Ninth Circuit recognized, the court must examine the totality of the circumstances to determine whether the petition was filed for a valid bankruptcy purpose. Here, and unlike in *Sylmar Plaza*, the debtor lacked such a purpose; it therefore did not meet its burden of demonstrating that the filing was in good faith.

Petitioner also contends that general confusion and varying standards currently exist among the circuits; this, however, is an attempt to manufacture a circuit split where none exists. While the exact phraseology may sometimes differ, the courts of appeals, in fact, apply the same analysis that the Third Circuit used in this case: whether the debtor's filing was consistent with the underlying purposes of the Bankruptcy Code. *See, e.g., Sylmar Plaza*, 314 F.3d at 1074 (good faith inquiry turns on whether the action "achieve[s] a result consistent with the objectives and purposes of the Bankruptcy Code"); *Carolin Corp.* v. *Miller*, 886 F.2d 693, 698 (4th Cir. 1989) (concluding that the good faith requirement is "indispensable to proper accomplishment of the basic purposes of Chapter 11 protection"); *Little Creek Dev. Co.* v. *Commonwealth Mort. Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1071 (5th Cir. 1986); *Westbrook* v. *Albany Partners Ltd. (In re Albany Partners Ltd.)*, 749 F.2d 670, 675 (11th Cir. 1984) ("In finding a lack of good faith, courts have emphasized an intent to abuse the judicial process and the purposes of the reorganization provisions."); *In re Madison Hotel Assocs.*, 749 F.2d 410, 426 (7th Cir. 1984) (explaining that the good faith standard "is generally interpreted to mean that there exists a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code").[3]

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[3] Petitioners also state that "the circuits are in hopeless analytical disarray as to the application of the standard to a debtor liquidating under Chapter 11" (Pet. 19), but do not cite any cases to support this proposition.

II. THE THIRD CIRCUIT APPLIED A SETTLED STANDARD TO A UNIQUE SET OF FACTS

The petition should also be denied because the judgment of the Third Circuit represents a routine application of the good-faith doctrine to the extreme facts of this case.

"[T]he requirement of good faith has been held to be an implicit condition to the filing and maintenance of a bankruptcy case for over a century." 7 *Collier on Bankruptcy* § 1112.07 (Lawrence P. King ed., 15th ed. rev. 1996).[4] It is well-settled, in the Third Circuit and the other courts of appeals, that determining whether the good-faith requirement has been satisfied is a "fact intensive inquiry" requiring an "examin[ation] of the totality of facts and circumstances." *SGL Carbon*, 200 F.3d at 162; *see also, e.g., Laguna Assocs. Ltd. P'ship* v. *Aetna Cas. & Sur. Co. (In re Laguna Assocs. Ltd.)*, 30 F.3d 734, 738 (6th Cir. 1994) (stating that an examination of good faith is "largely defined by factual inquiry" (internal quotations omitted)).

Based on the unique facts of this case, the court of appeals held that the Debtor ran afoul of the good faith requirement. There can be little doubt that this case presents extraordinary facts. The Debtor filed for bankruptcy even though it was not in financial distress, with more than $100 million in cash and (besides its debt to the Landlord) debts of less than $500,000. In addition, the Debtor filed without a bankruptcy purpose: it is undisputed that the Debtor was

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[4] The Bankruptcy Code expressly requires that the plan of reorganization be "proposed in good faith." 11 U.S.C. § 1129(a)(3). Moreover, though "good faith" is not one of the factors specified in 11 U.S.C. § 1112(b), which allows the court to dismiss or convert a Chapter 11 petition "for cause," courts have agreed that the factors are not exhaustive, and that the absence of good faith constitutes "cause" for dismissal under 11 U.S.C. § 1112(b). *See, e.g., Trident Assocs. Ltd. P'ship* v. *Metropolitan Life Ins. Co. (In re Trident Assocs. Ltd. P'ship)*, 52 F.3d 127, 130 (6th Cir. 1995); *Marsch* v. *Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994); *Humble Place Joint Venture* v. *Foray (In re Humble Place Joint Venture)*, 936 F.2d 814, 816 (5th Cir. 1991); *First Nat'l Bank of Sioux City* v. *Kerr (In re Kerr)*, 908 F.2d 400, 404 (8th Cir. 1990); *Phoenix Piccadilly, Ltd.* v. *Life Ins. Co. (In re Phoenix Piccadilly, Ltd.)*, 849 F.2d 1393, 1394 (11th Cir. 1988).

not attempting to reorganize, and there was no need for liquidation because the business was already liquid. Indeed, the Debtor's own Board minutes—which the court of appeals referred to as a "smoking gun" (Pet App. 41a)—reveal that the sole purpose for the filing was to frustrate the Landlord's claim.

Judges Ambro and Rendell, dissenting from the denial of the petition for rehearing en banc, specifically recognized the unique facts of this case, cutting to the gravamen of why this Court should deny certiorari: "the panel's opinion is limited to its snow in August facts." Pet. App. 78a; *see also id.* (noting the "unique facts this case presents").

Because the Third Circuit merely applied the well-established test for good-faith filings to the unusual and egregious facts of this case, its decision does not warrant this Court's review.

III. THE DECISION BELOW IS CORRECT

The Third Circuit reached the correct result in this case. As the Third Circuit has stated, courts must "patrol[]" the boundary between good and bad faith in order to ensure that the bankruptcy process is not used to "destroy and undermine the legitimate rights and interests" of others. *SGL Carbon*, 200 F.3d at 161 (internal quotations omitted); *see also Furness* v. *Lilienfield*, 35 B.R. 1006 (D. Md. 1983) ("The good-faith requirement provides courts with the necessary tool to circumvent a petitioner's attempt to commit fraud upon the court.").

To determine if a bankruptcy petition was filed in good faith, a court must conduct a fact-intensive inquiry and determine whether the petition serves one of the underlying purposes of the Bankruptcy Code. While these purposes are sometimes articulated in slightly different ways,[5] the Third

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[5] *See, e.g.*, H.R. Rep. No. 95-595, at 10 (1977) ("The present purposes of the Bankruptcy Act are twofold: either to rehabilitate financially a distressed debtor or to assemble and liquidate his assets for distribution to creditors." (footnote omitted)); *see also Bank of Am. Nat'l Trust & Sav. Ass'n* v. *203 N. Lasalle St. P'ship*, 526 U.S. 434, 453 (1999) (identifying two basic purposes of Chapter 11 as "preserving going concerns" and "maxi-

Circuit correctly concluded that there was no proper bankruptcy purpose for this filing. As noted above, it is undisputed that there was no intent to reorganize in this case, and there was no need to liquidate, as the Debtor's assets were already liquid. Moreover, as the Third Circuit held, the Debtor—which had more than $100 million in cash and negligible debts—was not even in financial distress within the meaning of the bankruptcy laws. Finally, the Debtor did not seek to maximize value for the benefit of creditors, but rather sought solely to obtain tactical advantage in its dispute with the Landlord and benefit its own shareholders at the Landlord's expense. In short, the Debtor's bankruptcy filing accomplished *nothing* other than frustrating the Landlord's claim. It was only on those extraordinary facts that the Third Circuit found that no valid bankruptcy purpose was served by the Debtor's filing.

Nor is there merit to petitioners' remaining claims of error. Faced with the court of appeals' proper application of settled law to the extreme facts of this case, petitioners strain to argue that the Third Circuit's decision represented a radical departure from existing law. Those contentions are meritless. First, petitioners contend that the Third Circuit erred by holding that a solvent entity is not permitted to file for bankruptcy, in contravention of the plain language of the Bankruptcy Code. Pet. 20-22. That is simply not so. To the contrary, the Third Circuit expressly acknowledged that "a debtor need not be insolvent before filing for bankruptcy protection." Pet. App. 24a. The Third Circuit merely followed the lead of many past decisions in that circuit and others recognizing that a financially healthy debtor—who is not in need of the bankruptcy remedy—is not ordinarily entitled to bankruptcy protection. *Id.* at 23a; *see, e.g.*, *SGL Carbon*, 200 F.3d at 166 ("Courts, therefore, have consistently dismissed Chapter 11 petitions filed by *financially healthy* companies with no need to reorganize under the protection

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mizing property available to satisfy creditors"); *Toibb* v. *Radloff*, 501 U.S. 157, 163-164 (1991) (pointing to "the congressional purpose of deriving as much value as possible from the debtor's estate").

of Chapter 11." (emphasis added)); *Connell* v. *Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762, 764 (1st Cir. 1991) (Breyer, J.) ("To meet the 'good faith' requirement ... many courts have held that a reorganization plan must bear some relation to the statutory objective of resuscitating a *financially troubled* corporation." (emphasis added)); *Baker* v. *Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.)*, 931 F.2d 222, 228 (2d Cir. 1991) ("Although a debtor need not be *in extremis* in order to file such a petition, it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future.").[6]

Similarly, petitioners accuse the Third Circuit of allowing its own view of the equities to "negate" the "plain language" of the Bankruptcy Code's provision capping landlords' damages claims. Pet. 23-24. But that analysis begs the threshold question of good faith. If a petition is filed in bad faith, the Bankruptcy Code's limitations on the rights of creditors are not "negated"—they never come into play at all. The Bankruptcy Code's restrictions on creditors' nonbankruptcy rights benefit only debtors with a proper bankruptcy purpose—not any entity who wants to make use of them to serve some purpose unrelated to the objectives of bankruptcy law.

Finally, petitioners contend that the Third Circuit erred by failing to realize that "distribution" of assets, without more, is a valid bankruptcy purpose, and suggests that the decision below will prevent many debtors from filing liquidating Chapter 11 plans. Pet. 24-28. That too is incorrect. As the Third Circuit recognized, liquidating plans are expressly permitted by Chapter 11. An orderly liquidation—

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[6] Petitioners' contention (Pet. 22) that the Debtor was "in economic distress"—meaning, according to petitioners, that it was out of business and no longer bringing in cash—misses the point. That kind of "economic distress" bears no relationship to the purpose of the bankruptcy laws. As the Third Circuit explained—and as petitioners do not dispute—"[t]he failure of [the Debtor's] business did not subject the company to any pressure on the value of its assets that could be reduced or avoided in an orderly liquidation under Chapter 11." Pet. App. 30a.

either by the sale of the debtor as a going concern or the sale of the debtor's individual assets—can serve the valid purpose of maximizing the value of the estate's assets in a way that would not be possible outside bankruptcy.[7] But the plan in this case, properly understood, was not a "liquidating" plan at all—all of the Debtor's assets had already been reduced to cash, and there was thus nothing to "liquidate." The distribution of an already liquid pile of cash does not require a bankruptcy filing. Accordingly, naked "distribution," without more, is not a valid bankruptcy purpose, and it cannot justify the use of the Bankruptcy Code for the sole purpose of relieving the debtor of a debt it could easily pay.

In the end, petitioners' contentions reduce to the untenable theory that any time a debtor seeks to take advantage of the provisions of the Bankruptcy Code, the requirement of good faith is satisfied. But, as the Third Circuit recognized, that position saps the good-faith requirement of all meaning, since *all* debtors file for bankruptcy in order to take advantage of the provisions of the Bankruptcy Code. "Just as a desire to take advantage of the protections of the Code cannot establish *bad* faith as a matter of law, that desire cannot establish *good* faith as a matter of law. Given the truism that every bankruptcy petition seeks some advantage offered in the Code, any other rule would eviscerate any limitation that the good faith requirement places on Chapter 11 filings." Pet. App. 38a. Indeed, if the good-faith filing requirement is met on these facts, it could be met in virtually any case. The Third Circuit properly held to the contrary, and nothing in its unexceptional decision justifies this Court's review.

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[7] Petitioners' suggestion (Pet. 10) that the Third Circuit imposed a requirement that the debtor be sold as a going concern in order to be eligible to liquidate is thus unfounded. Clearly a debtor may also liquidate by selling its assets piecemeal. Here, however, there were no illiquid assets to liquidate.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

INTEGRATED TELECOM EXPRESS, INC. AND THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS,

Petitioners,

v.

NMSBPCSLDHB, L.P.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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RULE 29.6 STATEMENT

Petitioners' corporate disclosure statement was set forth at page *ii* of the Petition for a Writ of Certiorari, and there are no amendments to that statement.

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INTRODUCTION

The issue presented in *In re Integrated Telecom Express* ("*Integrated*") is not whether a single debtor possessed bad faith in filing its chapter 11 petition nor is its effect limited to discrete, unique facts of an isolated case. Instead, the issue presented is broad: whether the Bankruptcy Code serves the interests of *creditors alone*, or whether the Bankruptcy Code also serves the interests of equity and other non-creditor constituents as well.

Integrated does not, as Respondent suggests, reflect "the application of a well-settled doctrine to an extreme set of facts." Opp'n 6. Rather, the Third Circuit's application of the ambiguous, unsettled, and ever malleable common law test for "good faith" became a cipher under these issue-laden facts for its adoption of an extremely controversial creditor-centric view of the Bankruptcy Code, which (as Judges Ambro and Rendell warned) is certain to extend beyond the facts of this case and to pervade and color other courts' analysis of chapter 11 filings generally.[1] Review of this case is therefore merited, to once and for all determine whether the purposes of the Bankruptcy Code serve creditors alone, to the exclusion of equity and all other non-creditor parties in interest.

The decision below is important precedent, certain to have an expansive impact both on bankruptcy law as well

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1. Decisions of the Third Circuit affect bankruptcy law and general business affairs to a greater degree than decisions from its sister circuits because a majority of large, publicly held corporations are incorporated in the State of Delaware and the venue choice for many corporate reorganizations is the District of Delaware. *See* Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987 (2002) (characterizing the District of Delaware as the "reorganization capital for large, publicly owned debtors"). If the Third Circuit's decision is left to stand, the creditor-centric view of the Bankruptcy Code is thus likely to become the *de facto* majority standard by virtue of this "marketplace" dynamic.

as economic affairs in general.[2] It is therefore well deserving of this Court's special scrutiny.

INTEGRATED CREATES A CLEAR CIRCUIT SPLIT

A. The Common Law Good Faith Filing Test Is Not "Settled" Because There is Pervasive Confusion Concerning the Underlying Policies of the Bankruptcy Code

Respondent suggests that the good faith filing test is "well[ ]settled" and disavows that there is any confusion among the circuits over the standard. Opp'n 9. Courts faced with applying good faith to the facts of a debtor's case have, however, been much less sanguine.[3] Courts have repeatedly criticized the doctrine's imprecision, describing it, for example, as "an amorphous gestalt, devoid of reasoning and impenetratable to understanding" and "a prime example of how courts should not formulate a rule of law." *In re Victoria Ltd. P'ship*, 187 B.R. 54, 61, 62 (Bankr. D. Mass. 1995).

Integrated has further exacerbated this impenetratable gestalt jungle. Although the Third Circuit used the usual talismanic phrase, "totality of circumstances," to describe its good faith test, it is the descriptions of the *purposes* of the Bankruptcy Code that are problematic, not the usual "totality" fact-based inquiry that assesses compliance with those polestar purposes.

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2. For just one example of how *Integrated's* creditor-centric doctrine is already infecting bankruptcy law in general see, *e.g.*, *Mirant Mid-Atlantic, LLC v. Morgantown OL1* LLC, No. 03-46590-DML-11, 2005 Bankr. LEXIS 619 (Bankr. N.D. Tex. April 7, 2005) (extending the doctrine and refusing to grant declaratory relief for recharacterization of claims, stating "[e]ven provisions of the Code which ... allow limitation of payment of creditor claims ... have been construed as limited to situations where the result is enhanced return to creditors").

3. Commentators have agreed: "[C]ourts have been all over the map in applying the 'teachings' of [the leading good faith precedents] *Marsh* and *SGL Carbon*." Robert J. Keach, *Solvent Debtors and Myths of Good Faith and Fiduciary Duty*, 23-10 AM. BANKR. INST. J. 36, 36 (2005) (particularly lamenting the disarray under a liquidating chapter 11).

Courts' grab-bag of explications of the purposes of bankruptcy as they relate to the good faith filing standard are so diverse they defy comprehension even with the aid of the most sophisticated attempts to flowchart the analysis.[4] *Integrated* itself is premised on a misreading of Supreme Court precedent, reading that precedent to limit use of chapter 11 to the maximization of creditor returns, rather than preservation or maximization of the value of non-creditor interests. The Third Circuit cited to *Bank of Am. Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999), for this principle, suggesting that because the Supreme Court had there identified two of the basic purposes of chapter 11 as (1) preserving going concerns and (2) maximizing property available to satisfy *creditors*, these were the *sole* purposes of the Bankruptcy Code.[5]

But the Bankruptcy Code contains many provisions directed to the protection of equity, and other, interests.[6] Chapter 11, therefore, not only serves the interests of creditors, but also protects value for other constituents as well. *See CFTC v. Weintraub*, 471 U.S. 343, 354-56 (1985).

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4. One court has been reduced to stating the purposes of bankruptcy under the good faith filing test in terms of whether the debtor "*need[ed]* Chapter 11 relief." *In re Liberate Techs.*, 314 B.R. 206, 211 (Bankr. N.D. Cal. 2004) (emphasis added). A query: what is that supposed to mean?

5. *203 N. LaSalle*, of course, was about the conditions under which old equity could purchase new equity in an insolvent chapter 11 debtor. One commentator has noted that its use by the Third Circuit in this context was "ironic, at best." *See* Keach, *supra* note 3 at 73 n.72.

6. *See, e.g.*, 11 U.S.C. § 1102 (appointment of equity security-holders committee); § 1129(b)(2)(c) (definition of fair and equitable plan as to class of interests); § 1129(a)(8) (requirement of acceptance by impaired class of interests); § 1123(a)(4) (prevention of discrimination among interests); § 1123(a)(7) (protection of interests of equity security-holders).

B. *In re Sylmar Plaza* is "On All Fours" with *Integrated*

The Respondent attempts to trivialize the doctrinal circuit splits that are both highlighted and exacerbated by the decision below in this case. In particular, the Ninth Circuit's decision in *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002), starkly demonstrates the schism between courts that view the Bankruptcy Code as limited to the service of creditors, versus others that view the Bankruptcy Code to serve a broader universe of parties in interest.

The Respondent charges that our invocation of the circuit split between the Ninth and Third Circuits "misrepresents the facts and holding of *Sylmar Plaza*." Opp'n 7. We respectfully suggest that this bare rhetoric shuns deeper analysis of policy concerns. Respondent's charge also fails to accord the proper deference and respect to the two lower courts, who each found *Integrated* to be almost "on all fours" with *Sylmar Plaza*.

More important, either ignoring or not recognizing the policy schism between the two circuits, the Respondent fails to analyze the very issue of law it claims harmonizes the two cases. Echoing the Third Circuit, Respondent simply proclaims (without analysis) that in *Sylmar Plaza*, unlike in *Integrated*, the Bankruptcy Code "was used to maximize value *for creditors as a whole*." Opp'n 7 (emphasis added). This is a surprising assertion, for in *Sylmar*, which was clearly a strategic filing, there was essentially only one creditor, whose claim was capped to maximize value for equity interests. In fact, the only cognizable substantive difference between the debtors in *Sylmar Plaza* and *Integrated* was the particular section of the Bankruptcy Code utilized by the debtor to cap the creditor's claim.[7] No court below has suggested that this distinction was material.

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7. Respondent's attempt to distinguish the cases based on the fact that in *Integrated*, the "financially healthy Debtor's assets consisted of

(Cont'd)

The essential split between the *Integrated* court and the *Sylmar* court lay not in any applicable distinction in the underlying facts. Rather, the divergent holdings in *Sylmar* and *Integrated* are rooted in these courts' differing analyses of the essential policy question: whether a non-creditor may benefit at the expense of a creditor.

The *Sylmar* court's answer: Yes. The *Integrated* court's answer: No. *See* Pet. 23.

THE THIRD CIRCUIT IMPROPERLY FOCUSED ON ONLY HALF OF THE VALUE MAXIMIZATION EQUATION

The Debtor possessed a proper distributional purpose for its chapter 11 liquidation filing. The Respondent points instead to the Third Circuit's depiction of the Debtor's goals as *redistributive*: "[t]o be filed in good faith, a petition . . . must seek to create or preserve some value that would otherwise be lost—not merely distributed to a different stakeholder—outside of bankruptcy." Opp'n 14; App. A 41a.

However, the Third Circuit's contention that the Debtor's purpose for entering chapter 11 failed to be properly "distributive" does not appreciate that the value maximization equation, *i.e.*, the timing and amount of distributions, is a function of not only by how *assets* are "liquidated," but also by how *claims* are "liquidated." The Third Circuit errs when it defines value creation entirely with reference to the asset side of the value equation, rather than the *net value* that efficient claim liquidation creates.

(Cont'd)

cash that passed through the bankruptcy unchanged in value," also fails. Opp'n 8 n.2. Respondent's statement is factually incorrect. Integrated was a doomed business and its entire intellectual property portfolio (*i.e.*, previously Integrated's essential value and engine of profitability) was liquidated within the bankruptcy case at an increase in value over what a non-bankruptcy sale would have brought. *See* Pet. 5.

Although the Third Circuit seems to deem certain portions of the Bankruptcy Code less worthy than others (when used by solvent debtors),[8] § 502(b)(6) performs no mere "redistributional" function. Rather, the provision was expertly designed by Congress to maximize net value to the estate—operating on the liabilities side of the value equation—by avoiding the difficulty and expense to the debtor in liquidating (*i.e.*, litigating) a landlord's speculative claim, which Congress considered "contingent and difficult to prove." S. REP. NO. 95-989, at 64 (1978).

Although Respondent argues that "the Debtor's bankruptcy filing accomplished *nothing* other than frustrating the Landlord's claim," Opp'n 12, Congress has decided otherwise, that an equitable and economically beneficial policy is served and that value is maximized where the estate is spared the time and expense of litigating a contingent landlord's claim by resort to § 502(b)(6).[9]

The Third Circuit's mischaracterization of § 502(b)(6) as a mere "[re]distributional mechanism" reveals its rejection of the congressional policies behind § 502(b)(6). The Debtor possessed a proper threshold liquidation purpose, both in terms of its use of § 502(b)(6)—and otherwise.[10]

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8. The Third Circuit also minimized the Debtor's use of § 510(b), without which the trial court found the liquidation would have been "stalled" indefinitely by a $93 million shareholder class action claim "deemed allowed" under § 502(a). *See* App. A 14a.

9. By comparison, the *Integrated* decision did nothing to advance an orderly liquidation or enhance value. Instead, by dismissing the case, the court is forcing the creditors and equity holders to return to the "first come first serve" state court arena where the size of their claims and their rights in various assets are unclear and the likely competition will only further reduce the size of the assets available for distribution.

10. As detailed in the Petition, the trial court found that the Debtor had many other valid purposes for its filing.

INTEGRATED CREATES UNTENABLE UNCERTAINTY AND RISK FOR CORPORATE OFFICERS AND DIRECTORS

Integrated—and the irreconcilable split with the Ninth Circuit left in its wake—leaves corporate boards wondering when (if ever) solvent debtors can file in good faith and what they can (or must) do to discharge their fiduciary duties to creditors and shareholders.

Integrated failed to address the critical issue of fiduciary duty. Outside of bankruptcy, the management of an entity has a duty to preserve and maximize the value of the enterprise for the benefit of the holders of equity interests. When the entity becomes insolvent, this duty also extends to creditors. 7-1108 COLLIER ON BANKRUPTCY ¶1108.09 (15th ed. rev. 2005).

The same principles apply in bankruptcy. Unquestionably, the fiduciary duty of the corporate debtor in possession runs to the shareholders as well as the creditors. The debtor in possession must treat all claimants and interest-holders "fairly, equally and in accordance with the priority of their claims under law." *Bergquist v. Felland (In re O-Jay Foods Inc.)*, Nos. BKY. 3-89-281, ADV. 3-90-40, 1991 Bankr. LEXIS 2122, at *45 (Bankr. D. Minn. July 5, 1991).

As applied to the facts of this case, if liquidation in chapter 11 of this failed but balance-sheet solvent entity would maximize the return to interest holders by limiting the amount of (or subordinating) claims, didn't Integrated's board have a duty to its shareholders to pursue a liquidating chapter 11?[11] Once in chapter 11, wouldn't that same duty

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11. Both the Bankruptcy Court and the District Court noted that Integrated's board "had an obligation" to take the steps it did and would have breached its fiduciary duty to the investors had they not filed the chapter 11 petition. App. B 55a; App. C 71a.

then have required the use of provisions, such as § 502(b)(6) and § 510(b), to maximize the value of the estate? Viewed within this framework, the board's acts in filing the chapter 11 petition (as their fiduciary duty to shareholders required) cannot be deemed in bad faith. Such acts prompted by the reasoned business judgment of corporate fiduciaries did not remotely merit the dismissal of this case.[12]

Petitioners respectfully suggest, therefore, that the facts present in *Integrated* are not akin to "snow in August." Rather, they reflect the all-too-common dilemma faced by the officers and directors of an economically distressed entity, whose fiduciary responsibilities require them to be men and women "for all seasons."

This dilemma exactly illustrates the disturbing problem with the rule in *Integrated*. Because the Third Circuit's good-faith inquiry is so fact-intensive and laden with delphically ambiguous eligibility requirements,[13] few boards can ever know in advance if resorting to chapter 11 will run afoul of *Integrated's* novel test or, alternatively, whether failing to file for chapter 11 will breach the board's fiduciary obligations to shareholders. Such uncertainty in the law creates a perverse incentive for boards to wait to file until assets have been needlessly squandered into insolvency. Fear and uncertainty produce inaction and inertia by the officers and directors, and the entity, its owners, and ultimately, the marketplace suffer economic loss as a result.[14]

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12. Respondent appears to agree that the case of a liquidating debtor should only be dismissed for intentional fraud. Opp'n 11 (stating that good faith operates as a tool to circumvent any "petitioner's attempt to commit *fraud* upon the court" (quoting *Furness v. Lilienfield*, 35 B.R. 1006 (D. Md. 1983) (emphasis added)).

13. The Third Circuit's ruling that the Debtor failed to show any "pressure on the value of its assets that could be reduced or avoided in an orderly liquidation" is merely another way of saying the debtor must be insolvent in the cash flow sense. *Cf.* Opp'n 13 n.6.

14. The Respondent makes much over the board resolution. But the resolution was forged out of the exigencies of the Debtor's (Cont'd)

For these reasons, Congress chose to delete the good faith filing standard that had previously been contained in the Bankruptcy Act when it enacted the Bankruptcy Code in 1978.[15] Congress also declined to insert any good faith eligibility test for chapter 11 filings in sweeping amendments to the Bankruptcy Code under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. (2005).

(Cont'd)

deteriorating financial condition and resultant need for a quick settlement with the Landlord. As such, the resolution is not indicative of the entire universe of purposes that existed for the Debtor's bankruptcy filing. Respondent fails to mention that the Debtor's petition in bankruptcy actually followed months later, after a subsequent board resolution dated October 8, 2002 authorized the filing.

15. The recommendations of the 1973 Commission on Bankruptcy Laws of the United States, adopted jot-for-jot into the Bankruptcy Code, articulate the reasons: a requirement of good faith in the filing would lead to fruitless litigation with creditors early in the case and was harsh on a debtor who needed some time to implement a plan. *See* Kennedy & Smith, *Postconfirmation Issues: The Effects of Confirmation and Post Confirmation Proceedings*, 44 S.C.L. REV. 621, 732-733 n.409.

Congress's decision to eschew a good faith filing requirement persists today. Although perceived abuse of the bankruptcy system was the impetus for enactment of the 2005 amendments, Congress declined to add "good faith" to the list of causes for conversion or dismissal under 1112(b)(2) in the 2005 amendments. *See* S. 256, 109th Cong. § 442 (2005).

CONCLUSION

"A rule of law should be susceptible to clear statement so that the result of its application to particular facts can be predicted with reasonable certainty. The good faith filing doctrine fails this test miserably." *In re Victoria Ltd. P'ship*, 187 B.R. at 61-62 (citing Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175 (1989)).

The good faith filing standard is neither clear, nor precise, nor uniform among the circuits. Unfortunately, the hopelessly confused body of case law on good faith now operates as a *de facto* eligibility test for a chapter 11 bankruptcy filing—regardless of whether this is contrary to Congress's intent. The test of good faith as a prerequisite to a bankruptcy filing is therefore both a proper and fitting subject for this Court's judicious review.

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IN THE
Supreme Court of the United States

INTEGRATED TELECOM EXPRESS, INC. AND THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS,

Petitioners,

v.

NMSBPCSLDHB, L.P.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MOTION OF *AMICUS CURIAE*, THE NATIONAL VENTURE CAPITAL ASSOCIATION, FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION AND BRIEF *AMICUS CURIAE*

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MOTION FOR LEAVE TO FILE A BRIEF AMICUS CURIAE.

The National Venture Capital Association moves for leave to file the attached brief *amicus curiae* out of time.[1]

The National Venture Capital Association ("NVCA") represents the interests of the U.S. venture capital industry, which supplies funding to young and innovative companies with great potential for growth who do not have the size, assets, or operating histories typically required to obtain capital from traditional sources. However, venture capital investments are "high risk" and the companies funded by our member experience a relatively high failure rate.

The Third Circuit's decision in this case limits the ability of a failed venture backed company to institute Chapter 11 proceedings in order to facilitate orderly liquidation and, thus, it will have a direct, continuing, and adverse effect on our members and the companies in which they invest.

This motion out of time is made because respondent was granted an extension of time to file its brief beyond the statutory date and had orally promised to provide a written acknowledgment of no objection to this brief amicus curiae. Counsel was surprised when respondent filed its brief,

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1. Per Supreme Court Rule 37.6, the Court is hereby advised that, no portion of this brief has been authored by the counsels of record for the parties. Wilson Sonsini Goodrich & Rosati PC has represented over 5000 venture capital backed companies, was general corporate counsel for Integrated Telecom Express, Inc., before the filing of its Chapter 11 petition, but is not counsel of record for the bankruptcy estate of Integrated Telecom Express, Inc. in this proceeding. . This court is further advised that the bankruptcy estate of Integrated Telecom Express, Inc. has agreed to reimburse the NVCA for a portion of the legal fees it will incur in filing this brief. The remainder of NVCA's fees is being donated by Wilson Sonsini Goodrich & Rosati PC.

without providing counsel with the promised acknowledgment. As a separate ground, the NVCA also was surprised that respondent is apparently contending that this case will have little application beyond its particular facts and wishes to advise the Court the potential far reaching effect on the venture capital industry of the Third Circuit's decision.

This Court has previously approved motions to file out of time *amici curiae* briefs. (See for example, *City of Simi Valley v. Young*, 531 U.S. 1104 (2001); *United States v. Salerno*, 479 U.S. 1015 (1986); *Int'l Union, Automobile Workers v. Brock*, 475 U.S. 1093, 477 U.S. 279 (1986); *Johnson v. Transportation*, 479 U.S. 912 (1986); *Patterson v. McLean Credit Union*, 487 U.S. 1231 (1988); and *Bowsher v. Synar*, 475 U.S. 1116 (1986).) The NVCA believes that its brief *amicus curiae* is equally deserving of consideration and hereby requests that it be considered.

Nature of Interest. NVCA members raise funds from institutional investors (large pension funds, insurance companies, endowments, foundations, etc.) for investment in the small companies that have become the nation's engine for technological growth. From 1970 through 2004, the venture capital industry invested over $350 billion in approximately 27,000 companies.

Venture capital backed companies have provided much of the impetus for America's leadership in biotechnology, medical device, software, and other high-technology industries. As a group they outperform their non-venture backed counterparts,[2] currently provide approximately 10 million U.S. jobs, generate almost $2 trillion in annual sales, and, by materially

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2. Despite the bursting of the "dot com" bubble, between 2000 and 2003, venture company sales grew at almost twice the rate of other U.S. companies and employment at venture backed companies grew by 6½%, while other U.S. employment shrank.

influencing the widespread use of technology, significantly contribute to a sustainable U.S. standard of living that outpaces other advanced economies.

The venture capital model assumes that, although some "new idea" venture backed companies will ultimately fail, others will provide an extremely healthy return. Some venture backed companies are extremely successful (e.g., Microsoft, Cisco, Federal Express, Amgen, Starbucks, Intel, and Google). Many others never develop a commercial product, never become profitable, and are dissolved within a few years of formation.

The instant case raises crucial issues concerning (i) the procedures for winding up the affairs of a failed business, (ii) the protections for venture capital investors under the Bankruptcy Code ("Code"), and (iii) the ability of the officers and directors of a venture backed company to discharge their fiduciary duties. The NVCA and its members have a direct interest in the ultimate resolution of these issues and the NVCA can provide unique and important insights to aid the Court's understanding of the actual effect the Third Circuit's decision will have.

The attached brief *amicus curiae* describes the typical venture capital business context in which the "good faith Chapter 11 filing" will arise, the untenable predicament this requirement creates for venture backed company debtors and their directors, and the legitimate interest of venture capital funds in protecting their interest in any remaining assets of a failed businesses in which they have invested.

Respectfully submitted,

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I. SUMMARY OF ARGUMENT.

Because of the relatively high rate of venture backed company failures, the U.S. economy's vital interest in an efficient allocation of venture capital from failed companies to more successful ones, and the difficulties presented in liquidating a business under state law, access to the federal bankruptcy courts for the winding up of failed venture backed businesses is of utmost importance to the venture community and the nation. Without statutory authority or persuasive legal precedent, the Third Circuit's decision in this case threatens to materially undermine this access and make the discharge by the directors of failed venture backed companies of their fiduciary duties practically impossible.

II. BACKGROUND ON VENTURE FINANCING.

In a typical venture capital transaction, several funds of venture capital, managed by professional venture capitalists ("VCs"), cooperate to provide a single, innovative, "start-up" company with the funds it will need to implement a business plan for the development and commercialization of a unique, and often untested, idea. To protect the interest of the institutional investors in such venture funds and to support the management of funded companies, VCs for the funds also sit on the company's board of directors and consult with company management on difficult issues. In return for these contributions, each venture fund receives an equity interest in the company (typically in the form of convertible preferred stock having a liquidation preference over common stock).[3]

To ensure that its resources and executive time are not squandered on a "bad idea", venture funds will commit, in

3. The company's management and employees also will receive a stake in the company through compensatory common stock and common stock options.

any given round of financing, only the budgeted capital required to achieve certain important milestones contained in the company's business plan. The company uses these funds to hire the facilities, equipment, and employees needed to implement the business plan. The providers of such facilities, equipment, and labor are typically well aware of the risks and possible rewards of dealing with such companies.[4] These providers do business with the company in order to reap a higher actual or potential return than they would experience with more established companies. As with the venture funds, these providers are "betting on the success" of the company.

Additional rounds of financing are supplied by the venture funds, only when and if the business plan milestones are satisfactorily attained. Failing such achievement,[5] a venture fund may refuse to make additional funding commitments and will redirect its capital to another, more promising, company.[6] If the start-up company cannot find a substitute investor, any remaining valuable company assets (typically intellectual property) will be sold and the company will be liquidated.

Not infrequently the failed company will be solvent. If claims against the company can be quantified and its assets sold free of liens, liquidation is relatively straight-forward

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4. The company's income statements shows no profits and its balance sheets will indicate a steadily dwindling level of cash, without any offsetting increase in readily marketable assets.

5. For example, lab research indicates a drug has little effect on target disease state, medical device clinical trials disclose an unacceptable side effect, or a software product is not well received by beta-testers.

6. This efficient redistribution of capital is a lynchpin of U.S. economic competitiveness.

— creditors are paid, the company's employees are terminated with full pay, free to pursue more promising careers elsewhere, and any remaining asset sales proceeds are returned to venture funds for redeployment to another start-up company for more productive uses. However, when the various claimants of the failed company cannot reach mutual agreement on the sharing of its remaining assets (which most typically arises when the amount of an important claim has not been liquidated or the value of a particular important asset is disputed), it is common and necessary for the debtor to seek bankruptcy court oversight to complete the liquidation process. Unless overturned or modified, the Third's Circuit's decision in *Integrated*, and its likely progeny, will have a significant adverse effect on this liquidation process.

III. A Chapter 11 Bankruptcy Proceeding Is the Most Efficient Forum for Resolving Competing Claims and Winding Up Failed Venture Backed Companies.

A. The State Law Alternatives For Failed Company Liquidation Are Undesirable.

When a venture backed company fails, the various claimants against its assets (e.g., lessors, employees, trade creditors, the venture funds, and other equity holders) all seek to collect upon their claims. Outside of Chapter 11, this claiming behavior is "first come, first serve," cooperation between claimants to optimize the debtor's estate value is not encouraged, and achievement of an overall final settlement is impossible, if any creditor is recalcitrant or unwilling to reach a settlement.[7] Unable to stop forced

7. For example, under California law, a lessor is not required to accept termination of a lease and may choose to collect rent as it comes due over the term of the lease (Cal. Civ. Code § 1951.4) making any final settlement virtually impossible

piecemeal dismemberment of the business at fire-sale prices, our venture fund members must stand by as the going concern value of the business is wasted and funds that could be invested in other developing companies is lost to attorneys and lucky bidders. Further, as the competition between claimants accelerates, collection costs incurred by higher priority creditors sky-rocket, increasing the size of their recoverable claims without creating any new offsetting value in the estate, further reducing any likelihood that venture funds will recover any return on their investments for redeployment to other promising opportunities.

B. Chapter 11 Is the Best, Most Efficient and Economical Forum For Liquidating A Failed Business.

The state law experience starkly contrasts with the Chapter 11 scheme, which encourages claimants to reach a consensual solution through negotiation, rather than court fiat and "grab" behavior. It allows company management, knowledgeable about the often special attributes of the debtor's assets (which often primarily consists of newly created intellectual property for a unique and uncommercialized product/service), to find new investors or sell the company's intellectual property to a buyer that appreciates the "idea" and is willing to risk additional capital to complete its development. Chapter 11 facilitates such sales,[8] often materially increasing the value realized from

8. For example, in the venture setting, outside of bankruptcy it is often impossible to retain the scientists and managers who developed (and are the only ones who understand) the remaining intellectual property assets when state law aggressive claiming behavior begins. Without this "human capital," the company's intellectual property may have little value. Chapter 11 provides mechanisms to preserve these relationships, so that the highest price can be obtained for the debtor's assets and the ideas that have been developed are not wasted.

the debtor's assets.[9] In addition, Chapter 11 fosters estate value optimization by improving the bargaining process and imposing controls over the state law creditor entitlements that promote individual claiming behavior in that setting. Consolidation of all claims, interests, and assets in one proceeding also reduces the aggregate societal cost of managing a business failure, making more funds available for investment in productive enterprises with long term growth opportunities that will benefit the U.S. economy.

Even outside of bankruptcy, the "shadow of the Bankruptcy Code" and its relatively predictable results encourage compromise, further increasing the pool of debtor assets that can be returned to venture funds and redeployed to more productive uses.

Thus, access, at the earliest opportunity, to the benefits of Chapter 11 for liquidation of a failed start-up company is of vital importance to NVCA members. They need to know when and how they can legally place a failed business under the protection and supervision of the bankruptcy court. Unless VCs can confidently predict and plan for a failed company liquidation, substantial monetary and human capital that could otherwise be made available to more promising ideas will be squandered on day-to-day negotiations in anticipation of a company's failure and on post-mortem activities for the failed company, and the technological research that was completed by the failed company will be lost.

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9. *Compare In re NuCentrix Broadband Networks, Inc. et al,* Case No. 03-39123 (Bankr. N.D. Tex. 2004). Initially filed when the debtor was insolvent, when an auction of the debtor's assets resulted in significantly higher than expected proceeds, a substantial distribution was made to equity holders.

IV. THE *INTEGRATED* DECISION IS INCONSISTENT WITH THE FIDUCIARY DUTIES IMPOSED ON FAILING COMPANY OFFICERS AND DIRECTORS.

A. As a Failing Company Moves Toward Insolvency, New Fiduciary Obligations Are Placed Upon Its Officers and Directors and These Parties Need Access to the Bankruptcy Courts.

Officers and directors of a corporation owe a continuing an even present duty of care to protect the interest of the corporation and its shareholders. *Ranalli v. Ferrari (In re Unifi Communications, Inc.)*, 317 B.R. 13 (U.S. Dist. 2004) [trustee permitted to claim breach of fiduciary duty damages against debtor's former directors on ground that directors improperly prolonged the debtor's existence]. When a company is dissolved or becomes insolvent, the duties of the officers and directors expand to include the company's creditors. These additional duties arise upon the first act of dissolution or at the first moment of insolvency, not merely when a bankruptcy or other insolvency petition is filed. *See Geyer v. Ingersoll Pub. Co.*, 621 A2d 784, 790 (1992); *Energy Products Eng. Inc. v. Boyle (In re Reuscher)*, 169 B.R. 398 (S.D. Ill. 1994).

Because a venture backed company is constantly depleting its capital (turning cash into R&D), after each round of financing, it is constantly moving closer to insolvency. VCs sitting as directors find themselves caught between obligations to protect the institutional investors in the venture funds they manage, their duties to the company's stockholders, and their emerging obligations to the company's creditors. When these competing interests cannot be readily reconciled, it is imperative that the VCs, in their role as directors, be able to access judicial instruction and protection and, because of the problems with the state law process discussed above, the best forum is the bankruptcy court.

If a venture backed company is denied access to bankruptcy protection due to decisions like the one in this case, directors will refuse to serve (because they will be legally unable to deal with often hostile competing claimants for the defunct company's assets) and the business acumen required to optimize the value of a failed business' remaining assets for the benefit of all claimants and interest holders will be unavailable, thereby placing a larger burden on the courts and the bankruptcy system to sort out competing claims.

B. The Integrated Decision Will Have Unintended And Unwarranted Consequences On Director Decision Making.

Liquidation (as well as rehabilitation) is a legitimate purpose of Chapter 11 and it is well established that solvency is not a statutory requirement for filing a Chapter 11 petition. *Compare* 11 U.S.C. § 109(d) *with* § 109(e)(3); *see also SGL Carbon Corp.*, 200 F. 3d 154, 163 (3rd Cir. 1999); *Platinum Capital Inc., v Sylmar Plaza L.P. (In re Sylmar Plaza L.P.),* 314 F.3d 1070, 1074-75 (9th Cir. 2002); *Sumida v. Yumen,* 409 F.2d 654 (9th Cir. 1969), *cert. den.*, 405 U.S. 964 (1972); *Bowers Distillery v. Kragness (In re Kragness),* 63 B.R. 459 (Bank. D. Ore. 1986).

The *Integrated* decision confuses the already treacherous legal landscape for dissolving a failing business, particularly where the actual value of creditors' claims and company assets is unclear. By holding that a board of directors' decision to file before insolvency constituted "bad faith," the Third Circuit places a failing company's directors in the awkward position of having to *precisely* time a bankruptcy filing to the very minute of insolvency. On one hand, the directors' duty to the company and its shareholders suggests that the company must be woundup as soon as a business plan fails and other financing is not found. However, under *Integrated,*

directors dare not even discuss bankruptcy liquidation with creditors (much less file a petition), so long as the company is solvent and a lessor's (or any other creditor's) claim will be capped or reduced because of a bankruptcy filing, for to do so is "bad faith."

C. Venture Backed Company Directors Cannot Discharge Their Duties to the Various Company Claimants Under the Rules Announced in the Integrated Decision.

Some courts have eschewed judicial adventurism by rejecting a good faith filing requirement, particularly when the filing was made to effectuate a liquidation. *See, e.g., In re Kragness,* supra, 63 B.R. 459 and *In re Goulding,* 79 B.R. 874 (Bankr. W.D. Mo. 1987). Unfortunately, many others find a good faith filing requirement in § 1112(b) of the Code and employ various "ad hoc" tests, which are impossible for our members to understand and apply. When viewed as a whole, the grounds the courts use to support a "bad faith filing" finding are almost as varied as the number of judges that have heard the dismissal motion.

Variously the decisions (i) balance the benefits of bankruptcy against harm to bankruptcy claimants (*In re Ripley & Hill, P.A.*, 176 B.R. 596, 598 (Bankr. M.D. Fla. 1994)); (ii) look to the motive for the filing (*Huckfeldt v. Huckfeldt (In re Huckfeldt,* 39 F.3d 825, 832, 833 (8th Cir. 1994); *Industrial Ins. Srv., Inc. v. Zick (In re Zick),* 931 F.2d 1124, 1129 (6th Cir. 1991)); (iii) exclude a debtor who has a "sinister or unworthy purpose", is "dishonest", "unscrupulous", has too few creditors, fails to advise a creditor of its intentions, has only one asset, has insufficient cash, or (as in this case) has too much cash. *See In re Huckfeldt,* supra, 39 F.3d 829, 832-33; *In re Brown*, 88 B.R. 280, 284 (Bankr. D. Haw. 1988), *Albany Partners, Ltd v. Westbrook (In re Albany Partners),* 749 F.2d 670 (11th Cir. 1984); and (iv) the list goes on and on.

Some courts have fashioned multiple factor tests. *Compare Industrial Ins. Srv., Inc. v. Zick,* supra, at 1129 [three factors]; with *In re Cappuccetti*, 172 B.R. 37, 39 (Bankr. E.D. Ark. 1994) [12 factors]). The court in *In re Landes*, 195 B.R. 855 (Bankr. E.D. Pa. 1996) held that there are three different types of tests — the "multi pronged test", the "frustrate bankruptcy purpose" test, and the so-called "Latimer" test.

In an admiral display of honesty (before dismissing the debtor's petition), the court in *Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Virginia (In re Phoenix Piccadilly, Ltd)* 849 F.2d 1393, 1394 (11th Cir. 1988) held that "there is *no particular test*" to determine whether a filing has been made in good faith. Emphasis added. Even more confusingly, some courts (such as the Third Circuit here) are now employing a "totality of the circumstances" test, opening the door for a resourceful attorney to argue that *any* fact is sufficient to shut the Chapter 11 bankruptcy door. In this case, the Third Circuit even concluded that the intention to liquidate a failed company is not persuasive as an indicia of good faith.

Taken together, it appears that, in concluding whether a petition was filed in good faith, most judges do little more than discuss the prominent factors present in the case. As stated in *In re Little Creek Dev. Co., Inc.,* 779 F.2d 1068 (5th Cir. 1986), "determining . . . good faith depends largely upon the bankruptcy court's *on the spot evaluation* of the debtor's financial condition and motives. . . . [L]ack of good faith . . . [has] been predicated on certain recurring, *but non-exclusive* patterns." Emphasis added.

Such an amorphous standard is unsuitable for today's business environment and particularly problematic for a venture capital community faced with more than its share of business failures. We urge this Court to grant certiorari to either eliminate "good faith" as a Chapter 11 filing requirement or, at a minimum, establish clear instructions for both the judiciary and the business community to follow. If the current precedent on this issue is allowed to stand and further mutate, Congress' intent concerning the appropriate conditions for filing a Chapter 11 petition (as set forth in §1112(b) of the Code) will be vitiated and substituted with an ever evolving test, allowing "a particular judge on a given day" to deny any debtor it deems unworthy access the bankruptcy courts.

Further, the dismissal motion will surely become the "motion of choice" for creditors disappointed by bankruptcy procedures. Seeking the earliest and least costly path to recovery, these creditors will ignore the other remedies available to them in the Code for improper debtor conduct and will pursue dismissal motions on increasingly novel grounds in an effort to return to the state court forum, where their powers are enhanced at the expense of mutual gain to all claimants and the economy.

V. THE *INTEGRATED* DECISION UPSETS THE CAREFUL BALANCE CONGRESS HAS FASHIONED BETWEEN LESSORS AND OTHER CLAIMANTS AND INTERFERES WITH THE ECONOMIC REDISTRIBUTION OF CAPITAL.

A. The Cap on Lessor Damages for Future Rent Is A Considered Compromise of Competing Interests.

Throughout bankruptcy history, leases have been treated differently from other contracts.[10] State law lease remedies typically take into account the amount of future rental the lessor is likely to receive when there is an early lease termination. Determination of this rent liability offset is subject to manipulation, becomes an "appraisers' war" and, in the case of a rising rental rate market, can significantly over-compensate a lessor, particular in a rising rental rate market. For these reasons, Congress has consistently either prohibited or capped the real estate lessor's claim for lost future rents.[11] The lessor's cap on future rent damages under § 502(a)(6) of the Code simplifies the determination of the allowable amount of the lessor's contingent claim and was enacted to balance the inequity to other claimants, resulting from other Code provisions that allow real estate lessors the

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10. *See* 11 U.S.C. § 365 (1994) [distinguishing leases from executory contracts]; H.R. Rep No. 95-595, p. 353-54 and S. Rep. No. 95-989, p. 63-65 [discussing damage caps and narrowing the meaning of the term "lease"].

11. Prior to the addition of § 202 to the Bankruptcy Act in 1934, real estate lessors were not allowed any recovery for lost future rent. Since that date, the one year cap has applied (with a minor modification in 1984, increasing the cap on leases with a remaining term of more than 6 1/3 years to the lesser of 15% of the remaining lease obligation or 3 years).

privilege of quickly regaining possession of their real estate for reletting (without sharing those proceeds with the other claimants and typically at a time when other claimants continue to wait for distributions from the debtor's estate).

Contrary to the implications of the *Integrated* decision, the drafters of § 502(b)(6) intended to prevent "*unique and disproportionate claims of landlords*." H.R. Rep No. 95-595, p. 353 (1978) and S. Rep. No. 95-989, p. 63 (1978), emphasis added.[12] An unstated, but central theme to the *Integrated* decision seems to be that the cap on a lessor's future damages is disfavored by the courts in any contest between a lessor and another claimant. *But see*, *Kuehner v. Irving Trust, Co.*, 299 U.S. 445 (1937). If this reasoning stands, Congress' carefully crafted statutory compromise (that trades early lessor recovery of its property for the cap on its contingent claim) and the generally accepted view that the cap is needed to protect other claimants will be entirely ignored without any policy justification.

B. Imposition of a Solvency Requirement In Any Form Will Interfere With The Economic Redistribution of Capital From Failed to Successful Businesses.

The *Integrated* decision can be construed to prohibit any solvent company from filing a Chapter 11 petition, if, by the filing of the petition, a lessor's (or any other creditor's) claim will be reduced (at least when assets are available for distribution to equity holders). Not only does this reasoning

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12. *See also Weeks v. Kinslow (In re Weeks)*, 28 B.R. 958, 960-61 (Bankr. W.D. Okla., 1983) [discussing Congressional compromise on the lessor cap]; *In re Mr. Gatti's Inc.*, 162 B.R. 1004, 1009-10 (Bankr. W.D. Tex. 1994) [discussing lease damage cap history and intent].

conflict with the generally accepted rule that a solvent company may use Chapter 11 to liquidate, as a matter of public policy it delays the decision to "pull the plug" on a failing business, wasting the precious funds our nation needs for advancement of technology to compete in the international business arena. *In re Marshall,* 298 Bankr. 60 (C.D. Cal. 2003) [substantial economic value will be lost, if debtors are forced to wait until they are insolvent to file]. In *Marshall*, the judge conducted a comprehensive search of the literature on the solvency requirement for bankruptcy, finding that early U.S. bankruptcy law and its English law predecessor did not tie bankruptcy to insolvency and that no bankruptcy law in the U.S. has ever required a voluntary debtor to prove insolvency. The court further found that the filing of a bankruptcy petition by a solvent debtor has never been seriously debated and has always been permitted under every bankruptcy law enacted in the U.S. and England.[13]

VI. Conclusion.

Sound public policy dictates that company officers and directors not be burdened with a judicially-created Chapter 11 good faith filing requirement not anticipated by § 1112(b) of the Code.[14] Distressed venture backed companies should have access to Chapter 11, even when solvent, for the purpose of liquidating their assets.

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13. This view is supported by *Railway Labor Exec. Ass'n. v. Gibbons*, 455 U.S. 457, 466 (1982), [bankruptcy concerns relations between nonpaying debtors and their creditors (as well as insolvency)].

14. The § 1112(b) list makes no mention of "good faith", "bad faith", "insolvency" or "adverse effect of a lessors damages."

However, if this Court is inclined to agree that "good faith" should play a role in determining access to Chapter 11, the basis for finding a lack of good faith should be capable of being readily understood and applied by our members.[15] The "good faith filing requirement", as currently envisioned by the Third Circuit in the *Integrated* decision, provides no assistance to our venture capital fund members, VCs, or their counsel, in determining when to file or not file a bankruptcy petition and creates a Gordian knot of conflicting fiduciary duties and mutually exclusive choices. Keach, *Solvent Debtors and Myths of Good Faith and Fiduciary Duty,* 23-10 Am. Bankr. Inst. J. 36 (2005).

The NVCA, therefore, encourages the Court to grant the petition in this matter for the purpose of reviewing *Integrated* and clarifying whether a "good faith" requirement can be legally applied by the Courts as a condition to the valid filing of a Chapter 11 bankruptcy petition, particularly when the filers intend to use Chapter 11 to liquidate the debtor's assets and distribute the value of those assets in accordance with the Code.

Respectfully submitted,

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15. *In re Victory Constr. Co.,* 42 Bankr. 145 (Bankr. C.D. Cal. 1984) [the doctrine "covers too many different kinds of conduct" and is "merely a pejorative phrase, functioning at such a high level of abstraction that one can scarcely discern what might be beneath it].